(4) (3)

Nos. 90-913 and 90-914

In the Supreme Court of the United States

OCTOBER TERM, 1990

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM OF THE UNITED STATES OF AMERICA, PETITIONER

v.

MCORP FINANCIAL, INC., ET AL.

MCORP, ET AL., PETITIONERS

v.

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM OF THE UNITED STATES OF AMERICA

ON WRITS OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

JOINT APPENDIX

HOWARD N. CAYNE
1200 New Hampshire Avenue, N.W.
Washington, D.C. 20036
(202) 872-6700
Counsel of Record for Respondents in No. 90-913

ALAN B. MILLER
767 Fifth Avenue
New York, NY 10153
(212) 310-8000

ROBERT J. ROSENBERG
885 Third Avenue
New York, NY 10022
(212) 906-1200
Counsel of Record for Petitioners in No. 90-914

KENNETH W. STARR
Solicitor General
Department of Justice
Washington, D.C. 20530
(202) 514-2217
Counsel for the Federal Reserve Board

PETITION FOR WRIT OF CERTIORARI IN No. 90-913 FILED DECEMBER 10, 1990
PETITION FOR WRIT OF CERTIORARI IN No. 90-914 FILED DECEMBER 10, 1990
CERTIORARI GRANTED MARCH 4, 1991

In the Supreme Court of the United States

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ON WRITS OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

TABLE OF CONTENTS

TABLE OF CONTENTS—Continued

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF TEXAS
HOUSTON DIVISION

Civil Action No. H-89-1677

MCORP, MCORP FINANCIAL, INC., and MCORP MANAGEMENT, DEBTORS IN POSSESSION, PLAINTIFFS, and OFFICIAL CREDITORS' COMMITTEE, INTERVENOR

v.

THE BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM OF THE UNITED STATES OF AMERICA, DEFENDANT

DOCKET ENTRIES

Date	Nr.	Proceedings
5-12-89		Received copy of Recommendation from Bkcy Court Signed by Judge Clerk.
5-12-89	2	(LNH) ORDER WITHDRAWING REFERENCE, filed. Counsel ntfd. cc/bkcy Reference to US Bankruptcy Court is withdrawn for Adversary No. 89-0298.
5-17-89	3	(LNH) ORDER FOR HEARING, entered. bj parties ntfd The hearing on MCorp's application for a preliminary injunction is set: June 1, 1989 at 2:00 p.m. Courtroom #7, 11th floor.
5-24-89	4	Creditors Committee UNOPPOSED MOTION for Intervention, filed
5-24-89	5	Memorandum in Support of Unopposed Motion for Intervention of The Official Creditors' Committee of MCorp Financial Inc. and MCorp Management, filed. bj

Date	Nr.	Proceedings
5-24-89		Rec'd 3 MOTIONS AND ORDERS PURSUANT TO LR1 for Robert J. Rosenberg, John P. Lynch and Deborah C. Paskin, fwd/crd.
5-2-89	6	ORIGINAL COMPLAINT, filed.
5-2-89	7	AFFIDAVIT OF GENE H. BISHOP IN SUPPORT OF EMERGENCY MOTION FOR TEMPORARY RESTRAINING ORDER AND PRELIMINARY INJUNCTION, filed.
5-2-89	8	PLAINTIFFS' MEMORANDUM OF LAW IN SUPPORT OF EMERGENCY MOTION FOR TEMPORARY RESTRAINING ORDER AND PRELIMINARY INJUNCTION, filed.
5-2-89	9	Pltfs MCorp's EMERGENCY MOTION PURSUANT TO FEDERAL RULE OF CIVIL PROCEDURE 65 AND BANKRUPTCY RULE 7065 FOR TEMPORARY RESTRAINING ORDER AND PRELIMINARY INJUNCTION, filed.
5-2-89	10	COMPREHENSIVE SCHEDULING, PRETRIAL AND TRIAL ORDER, entered. Parties notified. Pre-trial conference scheduled for January 9, 1990, at 2:00 PM. Trial to be held week of January 15, 1990. See Order for schedule of filing dates.
5-3-89	11	(LZClark) ORDER DENYING APPLICATION FOR TEMPORARY RESTRAINING ORDER AND SETTING HEARING ON APPLICATION FOR PRELIMINARY INJUNCTION, entered. Parties notified. Ordered, TRO denied.

Date	Nr.	Proceedings
		Ordered, hearing on Pltfs' App. f/Pre Inj. set for May 11, 1989, at 10:00 AM. Ordered, Pltfs' file instruments by May 5, 1989 @ 4:30 PM. Ordered, Pltfs responsible for notice of contents of this Order to Respondent by 5-5-89 at 3:30 PM.
5-3-89	12	CERTIFICATE OF SERVICE, filed. Served 5-2-89.
5-3-89	13	CERTIFICATE OF TELEPHONIC NOTICE, filed. Deputy Clerk Hill telephoned Kimberly Pinuiolo and D.J. Baker concerning Application for Preliminary Injunction.
5-4-89	14	CERTIFICATE OF SERVICE OF ORDER DENYING APPLICATION FOR TEMPORARY RESTRAINING ORDER AND SETTING HEARING ON APPLICATION FOR PRELIMINARY INJUNCTION, filed. Served 5-3-89, by Richard J. Goodier, atty for MCorp.
5-4-89	15	EXPEDITED MOTION OF DEFENDANT THE BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM FOR ENTRY OF ORDER STAYING PROCEEDINGS filed.
5-5-89	16	STATEMENT OF ISSUES, by Pltfs MCorp, filed.
5-8-89	17	(LZClark) ORDER, entered. Parties notified. Ordered, proceedings are stayed until further order of this Court or US Dist. Court for S. Dist. of Tx. with respect to the Board's motion for withdrawal of the reference.

Date	Nr.	Proceedings
5-10-89	18	Manufacturers Hanover Trust Company, as Indenture Trustee and Banco Atlantico, S.A.'s MOTION IN INTERVENTION, filed.
5-11-89	19	RECOMMENDATION FROM THE BANKRUPTCY COURT TO THE U.S. DISTRICT COURT ON THE MOTION OF THE BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM OF THE U.S. OF AMERICA FOR WITHDRAWAL OF REFERENCE ON ADVERSARY PROCEEDING 89-2098-H3.
5-11-89	20	Stephanie M. Morris' AFFIDAVIT OF SERVICE, filed.
5-11-89	21	COURTROOM MINUTES, United States Bankruptcy Court, filed. Re: Adversary 89-0298-H3: Preliminary Injunction. No hearing held; reference withdrawn by U.S. District Judge Hughes.
5/26/89	22	Deft's MEMORANDUM OF LAW in Opposition to Pltfs' Motion f/Preliminary Injunction, filed.
5/31/89	23	(LNH) ORDER, entered, Parties ntfd. br. Official Creditors Committee of MCorp, MCorp Financial, Inc. & MCorp Management is authorized to intervene in the proceeding & prosecute its compl. in Intervention.
5/31/89	24	COMPLAINT IN INTERVENTION of Official Creditors' Committee of MCorp, MCorp Fininacial, Inc. & MCorp Management, filed.
5-31-89	25	INTERVENOR OFFICIAL CREDITORS' COMMITTEE OF MCORP, MCORP FINANCIAL INC., AND MCORP MANAGEMENT'S MEMORANDUM IN SUPPORT OF EMERGENCY MOTION FOR TEMPORARY RESTRAINING ORDER AND PRELIMINARY INJUNCTION, filed.

Date	Nr.	Proceedings
5-31-89	26	PLAINTIFFS' REPLY MEMORANDUM OF LAW IN SUPPORT OF EMERGENCY MOTION FOR PRELIMINARY INJUNCTION, filed.
6/5/89	27	(LNH) ORDER enterd, parties notfd. jd Motionf to intervene by Manufacturere Hanover Trust Company and Banco Atlatico, S.A. re DENIED as moot.
6/5/89	28	(LNH) ORDER entered, parties notfd. jd Preliminary Inuunction Against the Federal Reserve System's Proceeding Administratively against MCorp. Status Conf. set for Aug. 15, 1989 at 10:00 a.m. (See Order for complete details)
6/1/89		Recvd. & forwarded to CRD Motion and Order Pursuant to LR 1
6/1/89	29	PLAINTIFFS' MOTION FOR LEAVE TO FILE DOCUMENTS UNDER SEAL AND TO PROTECT CONFIDENTIAL INFORMATION, filed M/D 6/26/89 by clerk
6/1/89	30	AFFIDAVIT of H. N. Cayne in Support of Emergency Motion f/Preliminary Injunction, filed.
6-1-89	31	(LNH) MINUTES OF INJUNCTION HEARING, filed. (rptr: Lauchner) Appearances: for Pltf: Baker, Miller, Fife, Barret, Case, Greg; for Deft: Stodgbill, Ashton, Pignuota, Strout, Hanlon, Parkins, Hanlon. See order for attorneys ad-

Date	Nr.	Proceedings
		mitted pro hac vice. Motion to Intervene of Manufacturers Hanover Trust and Bank Atlantico WITHDRAWN. Stipulation to exhibits admitted.
6-1-89	32	STIPULATION AS TO ADMISSION OF EXHIBITS, filed.
6-7-89	33	(LNH) ORDER, entered. Parties ntfd. These attorneys are admitted pro hac vice: Robert Rosenberg, Deborah Paskin, Charles Stodghill, Richard Ashton, Howard Cayne, Kevin Barret, Laurie Fife, Alan B. Miller, Dudley Murrey.
6-9-89	34	(LNH) OPINION ON THE PRELIMINARY INJUNCTION AGAINST THE FED. RESERVE SYSTEM, entered Parties ntfd. The board will be enjoined from processing its claims against the Debtor except through the bankruptcy court. (See Order f/details)
6-2-89	35	(LNH) Injunction Hearing (Day 2), filed. Reporter: Lauckner. Appearances: Same as 6-1-89. Record partially sealed. Injunction issued. (See Separate Order).
6-21-89	36	Answer Deft the Board of Governors of the Federal Reserve System, filed.
6-23-89	37	(LNH) PRELIMINARY INJUNCTION AGAINST THE FEDERAL RESERVE SYSTEM'S PROCEEDING ADMINISTRATIVELY AGAINST MCORP, entered. parties ntfd Under emergency scheduling, the parties may seek modification of this order after notice to the parties. The trial will not be set until the bankruptcy court has had a reasonable opportunity to address the issues raised by MCorp having subs. aries banks and

Date	Nr.	Proceedings
		non-banks. A status conference is set for Aug. 15, 1989 at 10:00 a.m. Tues.
6-23-89	38	(LNH) OPINION ON THE PRELIMINARY INJUNCTION AGAINST THE FEDERAL RESERVE SYSTEM, entered. bj parties ntfd See Order for Details.
6-28-89	39	TRANSCRIPT OF PROCEEDINGS BEFORE THE HONORABLE LYNN HUGHES, filed. Proceedings held June 1, 1989 @ 1:30 PM. Loose in filed.
7-26-89	40	Deft. Board of Governors of the Federal Rexerve System NOTICE OF APPEAL to Order entered Jun 5, 1989, filed. Dkt'd 8-15-89
8-4-89	41	Deft. Board of Governors of the Federal Reserve System TRANSCRIPT ORDER FORM advising that the transcript is already on file, filed.
6-19-90		Rec'd Order Modifying Injunction Against Certain Administrative Proceedings by the Federal Reserve System Against MCorp, fwd/crd
8-16-89	42	(LNH) MINUTES OF HEARING, filed. (Rptr: Jeanette Byers) Appearances: for Pltf: Baker, Miller, Stroube, Rosenberg for Deft: Stodghill, Ashton, Pignuolo. The Court shall be kept informed of any proceedings in Bankruptcy Court that obviate the need for the injunction in this case.
8-17-89		RECORD ON APPEAL consisting of All Original Papers (4 Vols. & 1 Expandable Folder-attach. #35-Sealed) and Transcripts (2 Vols.) forward to Court of Appeals.

Date	Nr.	Proceedings
8/18/89	43	TRANSCRIPT of proceedings before Judge Hughes on Aug. 15, 1989, filed (loose in file)
5-25-90	44	(LNH) INITIAL ORDER ON REMAND, entered Parties ntfd. The parties are to file proposed orders that conform to the opinion of the court of appeals by May 25, 1990. If convenient the court would appreciate receiving a 5-1/4" disk w/the draft order as an ASCII data file or a Word Perfect 5.0 file.
8/24/90	45	Certified Copy of JUDGMENT by Court of Appeals on May 15, 1990 issued as MANDATE on Aug 23, 1990, REMANDING to District Court and VACATING the preliminary injuction, filed.
8/24/90	46	Certified Copy of OPINION by Court of Appeals, filed.
8/24/90		Record on Appeal RETURNED by Court of Appeals, reassembled and sent to crd 10/9/90.
11-6-90	47	(LNH) INJUNCTION ON REMAND., entered Parties ntfd. See Order for Parties, Prior Proceedings, Restraint, Reasons, etc.
11-6-90	48	(LHN) Hearing., filed. Hrg held 11-6-90 Rptr- K Metzger
11-13-90	49	(LNH) ORDER, entered Parties ntfd. By Jan. 1/91 the FDIC shall replead its claims, retaining claim designations A through N, to correspond with the FDIC's original proof of claim, acquired by the FDIC. The FDIC may amend its complaint to include all claims that could have been (a) added through an amended proof of claim or (b) brought as an independent adversary action in the bankruptcy court. SEE CRDER FOR MORE DETAILS.

Date	Nr.	Proceedings
11/26/90	50	Deft. Board of Governors of The Federal Reserve System's MTN TO ALTER OR AMEND JUDGMENT, filed. M/D 12/17/90 by clerk.
11/26/90	51	Deft. The Board of Governors of The Federal Reserve System's MEMORANDUM IN SUPPORT OF ITS MTN TO ALTER OR AMEND JUDGMENT, filed.
11/30/90	52	(LNH) ORDER entered & ptys ntfd. Because the order filed in this case on 11/16/90, Instrument #49) should have been filed in C.A. No. 90-2929, it is struck.
12/12/90	53	Pltfs' RESPONSE TO MOTION OF BOARD OF GOVERNORS TO ALTER OR AMEND JUDGMENT OF THE COURT, filed.
12/27/90	54	(LNH) ORDER entered & ptys ntfd. Since the modified preliminary injunction resolves all issues pending the decision of the U.S. Supreme Court, this case is closed except for enforcement on a mtn of a pty or modification on remand.
12/27/90	55	(LNH) INJUNCTION ON REMAND entered & ptys ntfd. The Court decrees that The Board is enjoined from prosecuting an administrative proceeding against the debtors: (A) For an order to compel the debtors to (1) Transf. propoerty to their present or former subsidiary banks (or successors in interest to, or assigness of, those banks) or (2) Take or refrain from taking any action in respect of the debtors' propoerties; or

Date	Nr.	Proceedings
		(B) Enforce the Board's source of strength doctrine or (C) Regulate the day to day financial soundness of the subsidiary banks. The Court grants the restraint because a significant threat of irreparable harm to the pltfs exists if the injunction is not granted. (SEE ORDER FOR FURTHER REASONS & DETAILS)
1/28/91	56	Copy of Alan Miller's letter of November 12th to Judge Hughes, filed.

UNITED STATES COURT OF APPEALS
FOR THE FIFTH CIRCUIT

No. 89-2816

MCORP FINANCIAL, INC., MCORP MGT., and MCORP,
PLAINTIFFS-APPELLEES and

OFFICIAL CREDITORS' COMMITTEE OF MCORP,
MCORP FINANCIAL, INC., and MCORP MGT.,
INTERVENORS-APPELLEES

v.

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM
OF THE UNITED STATES OF AMERICA,
DEFENDANT-APPELLANT

DOCKET ENTRIES

DATE	FILING
Aug. 15, 1989	Appellant's Dup. Notice of Appeal Appelant's Record Excerpts Brief for Appellant Appellant's Motion to Expedite
Aug. 21, 1989	Appellees' Opposition to Motion to Expedite
Aug. 21, 1989	Appellant's Letter to Correct Opening Brief
Aug. 22, 1989	Appellant's Reply to Appellees' Opposition to Motion to Expedite
Aug. 22, 1989	Record on Appeal (6 vols.)
Aug. 22, 1989	Exhibits on Appeal (1 env.)
Aug. 25, 1989	Appellee Creditors Committee's Opposition to Motion to Expedite
Sept. 14, 1989	Brief for Appellee MCorp
Sept. 14, 1989	Brief for Appellee Creditors Committee

DATE	FILING
Sept. 29, 1989	Reply Brief for Appellant
Sept. 29, 1989	Case Assigned for Argument on Nov. 11, 1989
Nov. 11, 1989	Oral Argument
Dec. 20, 1989	Appellees' Rule 28(j) Letter
May 15, 1990	Opinion and Judgment
	* * * * *
June 28, 1990	Appellant's Petition for Rehearing
June 28, 1990	Appellees' Petition for Rehearing, With Suggestion of Rehearing En Banc
July 26, 1990	Appellees Jt. Response to Petition for Rehearing
Aug. 6, 1990	Order Denying Rehearing
Aug. 9, 1990	Appellees' Motion to Stay Mandate
Aug. 17, 1990	Appellant's Response to Motion to Stay Mandate
Aug. 23, 1990	Mandate Issued Record on Appeal and Exhibits Returned to Clerk

UNITED STATES COURT OF APPEALS
FIFTH CIRCUIT

No. 89-2816

MCORP FINANCIAL, INC., MCORP MGT., AND MCORP,
PLAINTIFFS-APPELLEES AND

OFFICIAL CREDITORS' COMMITTEE OF MCORP,
MCORP FINANCIAL, INC., AND MCORP MGT.,
INTERVENORS-APPELLEES

v.

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM
OF THE UNITED STATES OF AMERICA,
DEFENDANT-APPELLANT

Appeal from the United States District Court
for the Southern District of Texas

May 15, 1990

Before: GARZA, WILLIAMS and DAVIS, *Circuit Judges.*

W. EUGENE DAVIS, *Circuit Judge*:

The Board of Governors of the Federal Reserve appeals an order of the district court sitting in bankruptcy, enjoining the Board from pursuing its enforcement actions against MCorp without district court approval. 101 B.R. 483. Because the Board's source of strength proceedings exceed its statutory authority, we remand with instructions to enjoin the Board from further prosecution of these charges. Because the district court lacks subject matter jurisdiction to enjoin the Board's actions on the

remaining charges, we vacate the injunction as to these charges.

I.

In October 1988, the Board of Governors of the Federal Reserve (the Board), the primary regulator for bank holding companies, issued a notice of charges and of hearing against MCorp, a Texas-based bank holding company. The Board alleged that MCorp was engaging in unsafe and unsound practices, "likely to cause substantial dissipation of the assets of MCorp that could be used to allow MCorp to serve as a source of financial strength for the subsidiary Banks." A week later the Board issued an Amended Notice of Charges, which sought, among other things, to require MCorp to "implement[ ] an acceptable capital plan that would ensure that all of MCorp's available assets are used to recapitalize the Subsidiary Banks that are suffering capital deficiencies." MCorp's subsidiary banks were suffering heavy losses from real estate and energy loans.

In March 1989, three creditors of MCorp commenced an involuntary bankruptcy proceeding against MCorp in the U.S. Bankruptcy Court for the Southern District of New York. The Comptroller of the Currency (OCC), the primary regulator for national banks, subsequently declared a total of twenty of MCorp's subsidiary banks (MBanks) insolvent; OCC appointed the Federal Deposit Insurance Corporation (FDIC) as receiver, divesting MCorp of control of these banks. MCorp was left with five banks. MCorp and two of its subsidiaries, MCorp Financial and MCorp Management then filed voluntary Chapter 11 bankruptcy petitions in the U.S. Bankruptcy Court for the Southern District of Texas. The bankruptcy proceedings against MCorp and its subsidiaries (hereafter collectively referred to as MCorp) were consolidated into one jointly administered proceeding in the Texas forum.

In March 1989, by notice of charges and hearings the Board also commenced further administrative proceedings

against MCorp. The March charges accused MCorp and MCorp Management of violations of § 23A of the Federal Reserve Act, alleging MCorp caused MBank Houston and MBank Preston, two of the closed banks, to provide MCorp Management "unsecured extensions of credit." In late May the Board issued a second amended notice of charges, relating to the October notice of charges, alleging that MCorp had failed to act as a source of financial strength to its remaining subsidiary banks.

MCorp initiated an adversary proceeding against the Board in May 1989, and filed an Emergency Motion for a TRO and preliminary injunction, seeking to enjoin the Board from prosecuting its administrative proceedings against the debtors, and from initiating further administrative proceedings against the debtors without prior approval of the bankruptcy court. The bankruptcy court denied the TRO request. The Board moved the district court to withdraw the reference of the adversary proceeding to the bankruptcy court. The district court granted the Board's motion and placed the case on its own docket.

In June 1989, the district court entered a preliminary injunction granting the relief sought by the debtors. The district court preliminarily enjoined the Board from prosecuting its pending administrative proceedings and

> using its authority over bank holding companies or banks to attempt to effect, directly or indirectly, a reorganization of the MCorp group or its components or to interfere, except through participation in the bankruptcy proceedings, with the restructuring being developed in the bankruptcy proceeding.

The district court stated that the preliminary injunction left completely unaffected the Board's "general execution, supervisory and examination duties of the operations of MCorp and its bank subsidiaries and . . . central bank duties as they affect MCorp in common with all other institutions." The court established a procedure for future

Board proceedings, where the Board was first required to present to MCorp any new administrative proceedings, notices of charges or temporary cease and desist orders before their issuance. If the Board and MCorp could not agree whether a proposed proceeding was subject to the preliminary injunction, the Board could then present that issue to the district court. If the court decided the Board's proposed action related to the banks' "operations," the court proposed to exempt this action from the restraint of the preliminary injunction; if however the Board's proposed action affected the reorganization, the district court proposed to stay this action in deference to the bankruptcy court.

The Board appealed the preliminary injunction to this court.

II.

A.

The Board contends first that the district court, sitting in bankruptcy, has no jurisdiction to enjoin the Board's prosecution of its administrative actions, because of 12 U.S.C. § 1818(i) (the Financial Institutions Supervisory Act of 1966 (FISA) as amended), which provides:

> except as otherwise provided in this section no court shall have jurisdiction to affect by injunction or otherwise the issuance or enforcement of any notice or order under this section, or to review, modify, suspend, terminate, or set aside any such notice or order.

As we stated in *Groos National Bank v. Comptroller of Currency*, 573 F.2d 889 (5th Cir.1978), "section 1818(i) in particular evinces a clear intention that this regulatory process is not to be disturbed by untimely judicial intervention, at least where there is no 'clear departure from statutory authority.'" *Id.* at 895, *quoting Manges v. Camp*, 474 F.2d 97, 99 (5th Cir.1973). Thus, under 12 U.S.C. § 1818(h) and the Administrative Procedure Act (APA), a bank holding company is not ordinarily

entitled to judicial review until the Board issues a final order.

MCorp's principal argument that the district court properly exercised subject matter jurisdiction is predicated on 28 U.S.C. §§ 1334(b) and (d). MCorp argues that these sections of the Bankruptcy Code effectively supersede the Board's exclusive jurisdiction under § 1818(i)(1) to prosecute its enforcement actions, and therefore empower the court to enjoin prosecution of those actions. The district court presumably agreed and concluded that § 1818(i) conflicted with §§ 1334(b) and (d) of the Bankruptcy Code.

Section 1334(b) provides:

> Notwithstanding any Act of Congress that confers exclusive jurisdiction on a court or courts other than the district courts, the district courts shall have original but not exclusive jurisdiction of all civil proceedings arising under title 11, or arising in or related to cases under title 11.

The plain language of § 1334(b) does not purport to give the district court exclusive jurisdiction over matters arising under Ttitle 11 to the exclusion of administrative agencies; rather, § 1334(b) grants the district court concurrent jurisdiction over matters that otherwise would lie within the exclusive jurisdiction of another court.

The legislative history of § 1334(b) also supports the view that the section was intended to prevent another court from exercising exclusive jurisdiction over a matter brought within the Bankruptcy Code. The Commission on the Bankruptcy Laws of the United States, quoted at length in the House Judiciary Committee report, stated that "[the] first and most important objection to the present dispensation is the division of labor between the bankruptcy court and other courts." H.R. Rep. No. 595, 95th Cong., 1st Sess. 43 (1977), U.S.Code Cong. & Admin.News 1978, pp. 5787, 6005. Under the prior bankruptcy law, the jurisdiction of the bankruptcy

court was limited by the concepts of possession and consent. The House report adopted the reasoning of the Commission that the old law was undesirable because of "the frequent, time-consuming, and expensive litigation of the question whether the bankruptcy court has jurisdiction of a particular proceeding." *Id.* at 45, U.S. Code Cong. & Admin.News 1978, p. 6007. Under the prior jurisdictional scheme, "'when a "summary" proceeding in the bankruptcy court is appropriate and when a plenary suit is required is one of the most involved and controversial questions in the entire field of bankruptcy,'" the Committee observed. *Id.* at 45, U.S.Code Cong. & Admin.News 1978, p. 6007. We are persuaded therefore that it was this division of jurisdiction between bankruptcy courts and *other courts* which the jurisdictional changes of the new law were intended to address.

MCorp argues that the legislative history explains that § 1334(b) grants bankruptcy courts pervasive jurisdiction over all matters and proceedings that arise in or in connection with bankruptcy cases. Yet the legislative history reflects no intent that the bankruptcy court's jurisdiction supersede the exclusive jurisdiction of an administrative agency, or reinvest the courts with jurisdiction barred by § 1818.

In holding that § 1334 superseded § 1818(i), the district court did not harmonize the two statutes, but effectively repealed § 1818(i), and negated its basic sense and purpose of preventing early interference with administrative proceedings. This interpretation invested the district court, sitting in bankruptcy, with equitable power withheld from every other court by the language of § 1818(i). Implied repeals are highly disfavored, one statute will not be considered to impliedly repeal another unless there is a "positive repugnancy" between the two. *Tennessee Valley Authority v. Hill*, 437 U.S. 153, 189-190, 98 S.Ct. 2279, 2299-2300, 57 L.Ed.2d 177 (1978). We find no such irreconcilable conflict here. As the Supreme Court has stated:

> The "plain purpose" of legislation . . . is determined in the first instance with reference to the plain language of the statute itself. Application of "broad purposes" of legislation at the expense of specific provisions ignores the complexity of the problems Congress is called upon to address and the dynamics of legislative action. Congress may be unanimous in its intent to stamp out some vague social or economic evil; however, because its Members may differ sharply on the means for effectuating that intent, the final language of the legislation may reflect hard-fought compromises.

Board of Governors v. Dimension Financial Corp., 474 U.S. 361, 373-74, 106 S.Ct. 681, 688-89, 88 L.Ed.2d (1986) (citation omitted).

MCorp further contends that courts consistently have held that the phrase in § 1334(b), "[notwithstanding] any act of Congress that confers exclusive jurisdiction on [any other] court," was expressly intended to confer on the bankruptcy courts jurisdiction over all matters related to a debtor's Chapter 11 case, including administrative proceedings, citing *In re Casey Corp.*, 46 B.R. 473 (S.D.Ind.1985), and *In re Shelby County Healthcare Services of Ala., Inc.*, 80 B.R. 55 (N.D.Ga.1987). The district court relied in part upon *Casey* in holding that § 1334 superseded the jurisdictional bar of § 1818(i). These cases are not binding upon this court, however, nor do we find their reasoning persuasive as to the issue before us.

MCorp argues next that the bankruptcy court has exclusive jurisdiction over the Board's enforcement proceeding based on § 1334(d), which provides:

> The district court in which a case under title 11 is commenced or is pending shall have *exclusive* jurisdiction of all of the property, wherever located, of the debtor as of the commencement of such case, and of property of the estate. (emphasis added).

According to MCorp, because the bankruptcy court has exclusive control of MCorp's assets, it necessarily follows from the above section that the Board had no jurisdiction over MCorp. But the Board has not sought control over the property of MCorp's estate in this action, only the opportunity to go forward in its administrative proceedings. Nor at this early stage do we find the Board's enforcement actions to be sham proceedings, brought as a means of controlling the debtor's assets. We therefore do not consider § 1334(d) to grant the district court exclusive jurisdiction here.

MCorp relies on *In re Modern Boats, Inc.*, 775 F.2d 619 (5th Cir.1985), and *In re Louisiana Ship Management, Inc.*, 761 F.2d 1025 (5th Cir.1985), to support its argument. *Louisiana Ship Management* and *Modern Boats* both involved in rem proceedings in admiralty where vessels were under seizure. We held that once a chapter 11 petition was filed, the court where that petition was filed enjoyed exclusive jurisdiction over the vessels subject to a maritime lien and that the admiralty court had no jurisdiction over the property. MCorp's reliance on these cases is misplaced because the Board's proceedings do not directly concern the debtor's property.

MCorp also argues that because the above Bankruptcy Code provisions were enacted after § 1818, and do not exempt bank holding company administrative actions from the comprehensive jurisdiction of the bankruptcy court, Congress must have intended no such exemptions. MCorp contends that this is especially true in view of the express exemption granted banks from recourse to bankruptcy protection in § 109 of the Bankruptcy Code. Absent some clear intention to the contrary, however, a specific statute will not be controlled by a general one regardless of the priority of enactment. *Crawford Fitting Co. v. J.T. Gibbons, Inc.*, 482 U.S. 437, 107 S.Ct. 2494, 96 L.Ed.2d 385 (1987). Congress revealed no intent to supersede the specific jurisdictional bar of § 1818

(i) in the legislative history of the Bankruptcy Reform Act, nor the recently enacted Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (FIRREA), Pub.L. No. 101-73, 103 Stat. 183. We decline to imply any affirmative powers to the bankruptcy court from Congress' failure to act in this area.

In analogous circumstances, several circuits have held that the automatic stay provisions of the Bankruptcy Code in the case of a bankrupt employer do not supersede the anti-injunction provision of the Norris-LaGuardia Act, which precludes courts from enjoining union conduct. In *In Re Crowe & Associates, Inc.*, 713 F.2d 211, 214-16 (6th Cir.1983), the Sixth Circuit concluded that the legislative history of the Bankruptcy Reform Act was silent as to the anti-injunction provisions of the Norris-LaGuardia Act, and this silence was "self-evident proof that Congress never intended to supersede or transcend [the Norris-LaGuardia Act], since we cannot believe that the Norris-LaGuardia Act was to be superseded *sub silentio*." *Id.* at 215, *quoting In re Petrusch*, 667 F.2d 297, 300 (2d Cir.1981); *see also Briggs Transportation Co. v. International Brotherhood of Teamsters*, 739 F.2d 341, 343 (8th Cir.1984) ("the parties have cited us to nothing in the Bankruptcy Code or its legislative history indicating a congressional intent to lift the jurisdictional restrictions of the Norris-LaGuardia Act").

The Board also relies on *Becker's Motor Transportation, Inc. v. Needham's Motor Service, Inc.*, 632 F.2d 242 (3d Cir.1980), *cert. denied*, 450 U.S. 916, 101 S.Ct. 1358, 67 L.Ed.2d 341 (1981), in which the court held independent statutory provisions barring any suit to restrain the assessment or collection of taxes deprived the bankruptcy court of the authority to enter an injunction against the government's tax collection efforts. In reaching this conclusion the Third Circuit in *Becker's Motor* distinguished *Bostwick v. United States*, 521 F.2d 741 (8th Cir.1975), a tax injunction case relied upon by MCorp and the lower court in which the Eighth Circuit reached the contrary

result. The court in *Becker's Motor* concluded that the *Bostwick* court created a judicial exception to the tax anti-injunction statute in contravention of clear congressional intent. *Becker's Motor*, 632 F.2d at 246. We agree with the Third Circuit that absent clear congressional intent any argument for permitting the bankrupcty court's jurisdiction to supersede existing anti-injunction legislation should be addressed to Congress, and we will not imply the repeal of such legislation.

For the above reasons, we conclude that the plain language of § 1818(i) deprives the district court of jurisdiction to enjoin the Board's administrative proceedings if the Board's actions do not exceed the authority Congress granted to it. We turn next to MCorp's argument that the Board is exceeding its statutory authority.

B.

MCorp asserts that the Board lacks authority to proceed against banks in FDIC receivership, that the Board's self-dealing charges are a pretext for avoiding the exclusive jurisdiction of the bankruptcy court over MCorp's assets, and that the Board's source of strength policy is without statutory authority.

In *Manges v. Camp*, 474 F.2d 97 (5th Cir.1973), we recognized that the statute at issue here, § 1818, that withdraws the jurisdiction of the court in deference to an agency, is not effective when the agency exeeds its authority under that statute. There is "a very strong court created exception to withdrawal statutes. This exception comes into play when there has been a clear departure from statutory authority, and thereby exposes the offending agency to review of administrative action otherwise made unreviewable by statute." *Manges*, 474 F.2d at 99. If the Board's proceedings exceed its statutory authority, we may review the Board's action prior to a final order despite the jurisdictional bar of § 1818; if the Board "was not acting within [the] authority granted by Congress,

then 12 U.S.C. § 1818(i) could not withdraw jurisdiction." *Manges*, 474 F.2d at 99.

The Supreme Court established this exception in *Leedom v. Kyne*, 358 U.S. 184, 79 S.Ct. 180, 3 L.Ed.2d 210 (1958). In *Leedom* the Court found district court review proper, despite an express preclusion provision, where the National Labor Relations Board had acted in excess of its delegated powers.

The Court stated in *Leedom* that "[t]his suit is not one to 'review,' in the sense of that term as used in the [National Labor Relations] Act, a decision of the [National Labor Relations] Board made within its jurisdiction. Rather it is one to strike down an order of the Board made in excess of its delegated powers. . . ." *Leedom*, 358 U.S. at 188, 79 S.Ct. at 183. The D.C. Circuit recently characterized the *Leedom* rule as one permitting a court in the face of a withdrawal statute to determine "whether an agency has acted 'in excess of its delegated powers'" and "whether the agency action 'on its face' violated a statute." *Dart v. United States*, 848 F.2d 217, 222 (D.C. Cir.1988). *See Coit Independence Joint Venture v. Federal Sav. & Loan Ins. Corp.*, —— U.S. ——, 109 S.Ct. 1361, 103 L.Ed.2d 602 (1989); *Breen v. Selective Service Local Board*, 396 U.S. 460, 90 S.Ct. 661, 24L.Ed.2d 653 (1970); *Oestereich v. Selective Service System Local Board*, 393 U.S. 233, 89 S.Ct. 414, 21 L.Ed.2d 402 (1968). *Cf. Bowen v. Michigan Academy of Family Physicians*, 476 U.S. 667, 680 n. 11, 106 S.Ct. 2133, 2141 n. 11, 90 L.Ed.2d 623 (1986).

MCorp argues that the Board exceeded its authority in three respects because it has no authority to (1) regulate MCorp's relationships with *former* MBanks, now under FDIC receivership, which are the subject of the administrative proceedings; (2) assist the FDIC, as receiver of the closed MBanks, to obtain damages under the pretext of punishing MCorp for violations of § 23A of the Federal

Reserve Act [1] which concerns self-dealing among holding company subsidiaries; and (3) compel a bank holding company to transfer its funds to subsidiary banks.

MCorp argues first that the Board lacks authority to regulate MCorp's relationships with former subsidiary banks now under FDIC receivership. Both the "source of strength" charges and the self dealing charges, as initially set out by the Board, were levelled in part to the relationship between MCorp and MBanks which were later closed and placed under FDIC receivership. We are persuaded that the Board is at least entitled to make a determination on the legitimacy of the credit transaction with the closed banks at issue to allow it to evaluate what remedy it wants to pursue against MCorp. Certainly the Board's attempt to do that is not facially invalid.

MCorp next argues that the Board's § 23A proceeding is simply an attempt to assist the FDIC to obtain MCorp's property under the guise of remedying a violation of § 23A of the Reserve Act. We disagree. The Board is well within its authority in seeking an order against MCorp to cease and desist any transactions which violate the provisions of § 23A, or "to take affirmative action" as may be appropriate. 12 U.S.C. § 1818(b)(1). The notice of charges relating to the appropriateness of the credit transactions between an MCorp nonbank subsidiary and two of MCorp's former subsidiary banks is not on its face a sham proceeding initiated only to assist the FDIC to collect damages; at least a fact issue is presented on the merits of the § 23A charges. The

[1] Section 23A of the Federal Reserve Act, 12 U.S.C. § 371c, prohibits a bank from extending credit to a nonbank affiliate unless the extension of credit is secured by collateral having a market value of at least 100 percent of the loan. The Board has charged that MCorp violated this requirement by causing two of its former subsidiary banks to extend $63.7 million of unsecured credit to an affiliated subsidiary of MCorp, and failing to make timely repayments to the subsidiary banks that extended the credit.

mere prosecution of the charges before the Board does not in itself disturb the bankruptcy court's alleged exclusive jurisdiction over MCorp's property under § 1334(d).

We are persuaded, however, that a serious legal issue is presented as to whether the Board has statutory authority to pursue its source of strength charges. Before turning to that problem, we address a threshold argument of the Board that we are precluded from considering the Board's authority to proceed.

The Board contends that MCorp may not judicially challenge at this stage the Board's authority to proceed with its charges because MCorp has not exhausted its administrative remedies. The Board relies on *Myers v. Bethlehem Shipbuilding Corp.*, 303 U.S. 41, 58 S.Ct. 459, 82 L.Ed. 638 (1938), in which the Court stated that "[j]udicial relief is not normally available for supposed or threatened injury until the prescribed administrative remedy has been exhausted." *Id.* at 50, 58 S.Ct. at 463.

Myers did not present a challenge to the agency's authority to act on the complaint presented to it. The petitioning employer factually challenged the interstate nature of the employer's business, one of the elements of the NLRB's charge. The Court concluded that this factual determination should be made by the NLRB. The Supreme Court held that a federal district court is without jurisdiction to enjoin the NLRB from "hearing and determining what Congress declared the [National Labor Relations] Board should hear and determine in the first instance." *Id.* at 50-51, 58 S.Ct. at 463-464 (footnote omitted).

The question of the Board's authority to impose its source of strength requirement is quite a different issue. No facts are in dispute. The sole question presented is a legal one: whether the Board has authority to order a holding company to transfer its funds to its troubled subsidiary banks. The Board has instituted proceedings

to require that holding company to transfer those funds. The legal issue of the Board's authority can be resolved without further factual development. "[P]rompt resolution will eliminate uncertainty and be in the interest of efficient judicial administration." *Indep. Bankers Ass'n v. Heimann*, 613 F.2d 1164, 1167 (D.C.Cir.1979), *cert. denier*, 449 U.S. 823, 101 S.Ct. 84, 66 L.Ed.2d 26 (1980). Because we conclude that MCorp is not required to exhaust its administrative remedies in this circumstance, we turn to the merits of whether the Board has authority to require the holding company to transfer its funds to troubled subsidiary banks.

The Board contends it has authority to issue the source of strength charges under §§ 1818(b)(1) and (3), which empower it to file charges against a bank holding company which the Board believes (1) has violated or is about to violate a "law, rule or regulation"; or (2) is engaging in an "unsafe or unsound" practice.[2] The Board

[2] Termination of status as insured depository institution, Section 1818 which is captioned in § (b)(1) and (3):

(b) Cease-and-desist proceedings

(1) If, in the opinion of the appropriate Federal banking agency, any insured depository institution . . . is engaged or has engaged, or the agency has reasonable cause to believe that the depository institution . . . is about to engage, in an unsafe or unsound practice in conducting the business of such depository institution, or is violating or has violated, or the agency has reasonable cause to believe that the depository institution or any institution-affiliated party is about to violate, a law, rule, or regulation . . . the agency may issue and serve upon the depository institution or such party a notice of charges in respect thereof . . .

(3) This subsection . . . shall apply to any bank holding company, and to any subsidiary (other than a bank) of a bank holding company, as those terms are defined in the Bank Holding Company Act of 1956. . . . Nothing in this subsection or in subsection (c) of this section shall authorize any Federal banking agency, other than the Board of Governors of the Federal Reserve System, to issue a notice of charges or cease-and-desist order against a bank holding company or any subsidiary thereof (other than a bank or subsidiary of that bank).

12 U.S.C. §§ 1818(b)(1) and (3), *amended by* FIRREA, Pub. L. No. 101-73, §§ 901(d), 902(a)(1)(A).

contends that MCorp has failed to act as a source of strength for its bank subsidiaries in violation of the Board's regulations and policy statement. The Board also contends that this failure constitutes an unsafe or unsound practice in violation of § 1818.[3]

We consider first whether the authority the Board assumed under its regulation and policy statement exceeds its statutory grant. The Bank Holding Company Act of 1956 (BHCA), 12 U.S.C. § 1841 et seq., grants the Board supervisory control over the formation, structure and operation of bank holding companies and their nonbank subsidiaries. Section 3(a) of the Act, 12 U.S.C. § 1842(a), provides that no company may acquire control of a bank without prior approval by the Board. In determining whether to approve an application, § 3(c) of the Act, 12 U.S.C. § 1842(c), directs the Board to consider "the financial and managerial resources and future prospects of the company or companies and the banks concerned."[4]

[3] Because we conclude that the source of strength proceedings exceed the Board's statutory authority, we need not resolve whether the source of strength charges relating to MCorp's former subsidiary banks are beyond the Board's authority.

[4] Section 1842 states in relevant part:

Acquisition of bank shares or assets

* * *

c) Factors governing determination of application for approval . . .

In every case, the Board shall take into consideration the financial and mangerial resources and future prospects of the company or companies and the banks concerned, and the convenience and needs of the community to be served.

In 1984, as part of its comprehensive revision of Regulation Y, the Board added 12 C.F.R. § 225.4(a)(1), which provides:

> § 225.4 Corporate Practices
>
> (a) *Bank holding company policy and operations.*
>
> (1) A bank holding company shall serve as a source of financial and managerial strength to its subsidiary banks and shall not contuct [*sic*] its operations in and unsafe or unsound manner.

Revision of Regulation Y, 49 Fed.Reg. 820 (1984) (codified at 12 C.F.R. § 225.4(a)(1)).

In April 1987, the Board published a policy statement in the Federal Register, which further provided:

> It is the policy of the Board that in serving as a source of strength to its subsidiary banks, *a bank holding company should stand ready to use available resources to provide adequate capital funds to its subsidiary banks* during periods of financial stress or adversity and should maintain the financial ffexibility and capital-raising capacity to obtain additional resources for assisting its subsidiary banks. . . . A bank holding company's failure to meet its obligation to serve as a source of strength to its subsidiary bank(s), including an unwillingness to provide appropriate assistance to a troubled or failing bank, will generally be considered an unsafe and unsound banking practice or a violation of Regulation Y, or both. . . . .

Policy Statement, 52 Fed.Reg. 15707, 15708 (1987) (emphasis added). This policy statement was effective April 24, 1987. The Board solicited comments on the policy, with a view to revising the statement in light of such comments. No subsequent revision has been published.

The Board also relies on the broad language of § 5(b) of the BHCA, 12 U.S.C. § 1844(b), for authority to issue

the above regulation and policy statement. Section 5(b) states:

> The Board is authorized to issue such regulations and orders as may be necessary to enable it to administer and carry out the purposes of this chapter and prevent evasions thereof.

The Board finds support for its authority to enforce its source of strength requirements in *Board of Governors v. First Lincolnwood Corp.*, 439 U.S. 234, 99 S.Ct. 505, 58 L.Ed.2d 484 (1978). In this case the Court considered whether the BHCA authorized the Board to disapprove an application of a proposed bank holding company solely on grounds of financial unsoundness, and in the absence of any anticompetitive effects resulting from the transaction. The Supreme Court answered this question in the affirmative and upheld the Board's rejection of a proposed holding company's application. This holding was based on the statutory language of 12 U.S.C. § 1842(c), as well as the legislative history of the BHCA. The Supreme Court stated:

> The language of the statute supports the Board's interpretation of § 3(c) as an authorization to deny applications on grounds of financial and managerial unsoundness even in the absence of any anticompetitive impact. Section 3(c) directs the Board to consider the financial and managerial resources and future prospects of the applicants and banks concerned "[i]n every case," not just in cases in which the Board finds that the transaction will have an anticompetitive effect.

Id. at 243, 99 S.Ct. at 510.

In response to the court of appeals' holding that the Board's authority to deny an application because of unsound financial or managerial consideration was limited to instances in which the unsoundness was caused or exacerbated by the proposed transaction, the Court stated:

> Indeed, the Court of Appeals' construction of the statute would require the Board to approve formation of a bank holding company with corrupt management simply because management would become no more corrupt by virtue of the transaction. We hesitate to adopt a construction that would yield such an anomalous result.

Id. at 250, 99 S.Ct at 514.

Finally, addressing the arguments of the dissent, the Court stated that its holding was not intended to extend the Board's authority to day-to-day supervision of banks, but allowed the Board to disapprove an application to prevent the formation of an unsound holding company.

> In the dissent's view, the Board, by looking beyond the transaction before it, attempted to exercise the day-to-day regulatory authority over banks which Congress denied to it and conferred on the Comptroller. We disagree with the basic premise of the dissent's argument. As the Board found, the *effect* of this transaction would have been the formation of a financially unsound bank holding company. Thus, the Board's attempt to prevent this effect and to induce respondent to form an enterprise that met the Board's standards of financial soundness was entirely consistent with the language the dissent cites.

Id. at 252 n. 18, 99 S.Ct. at 515 n. 18 (emphasis added). In *First Lincolnwood*, therefore, the Court relied upon the express provisions of § 3(c) that required the Board to consider financial soundness of the subsidiary bank in determining whether to approve a holding company's application. The Court made it clear that it did not read the BHCA to grant the Board authority to regulate the day-to-day financial soundness of the subsidiary banks.

The Supreme Court in *Board of Governors v. Dimension Financial Corp.*, 474 U.S. 361, 106 S.Ct. 681, 88

L.Ed.2d 691 (1986), considered whether the Board exceeded its authority in expanding certain definitions in Regulation Y. The Board, as part of Regulation Y, included institutions that were not banks within the Board's regulatory ambit. The Court concluded that the Board had exceeded its authority in attempting to regulate the "nonbank banks."

The Court found that the BHCA "vests broad regulatory authority in the Board over bank holding companies 'to restrain the undue concentration of commercial banking resources and to prevent possible abuses related to the control of commercial credit.'" *Id.* at 365, 106 S.Ct. at 684, *quoting* S.Rep. No. 91-1084 (1970), U.S. Code Cong. & Admin.News 1970, p. 5541. The Board's new definitions did not fall within the plain purposes of the BHCA, the Court concluded. The Court added that "§ 5 only permits the Board to police within the boundaries of the Act. . . ." *Id.* at 373 n. 6, 106 S.Ct. at 688 n. 6.

First Lincolnwood and *Dimension Financial* together teach that the primary purposes of the BHCA are to prevent the concentration of control of banking resources, and to separate banking from non-banking enterprises. *First Lincolnwood* is narrowly written and expressly limits the Board's authority to consider financial and managerial soundness of subsidiary banks to the Board's decision to grant or deny a holding company's application. Section 3(c) of the BHCA specifically grants this authority to the Board. The BHCA does not grant the Board authority to consider the financial and managerial soundness of the subsidiary banks after it approves the application, and *First Lincolnwood* finds this regulatory authority lacking in the day-to-day operations of a subsidiary bank. For these reasons, we conclude that the Board is without authority under the BHCA to require MBank to transfer its funds to its troubled subsidiary bank.[5]

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[5] As a condition to approving an application, the Board could possibly require the holding company to agree to maintain the sub-

The Board asserts as an independent basis for its source of strength regulation, policy statement and enforcement proceedings its broad authority under § 1818 (b)(1) and (3) of FISA to order a holding company to cease and desist from any activity that, in the Board's judgment, constitutes an unsafe or unsound practice. The Board argues that MCorp's failure to provide capital to its subsidiary banks is an unsafe or unsound practice which the Board may act to restrain under § 1818.

In determining whether we should accept the Board's interpretation of a statute the Board is charged with enforcing, we look to the test established by the Supreme Court in *Chevron U.S.A. v. Natural Resources Defense Council, Inc.*, 467 U.S. 837, 104 S.Ct. 2778, 81 L.Ed.2d 694 (1984).

> If Congress has spoken clearly to the issue presented in a case, that intent controls. 467 U.S. at 844 [104 S.Ct. at 2782]. If the agency's interpretation is contrary to the clear intent of Congress, the agency's interpretation is invalid. If, on the other hand, Congress has no clear intent as to the particular question at issue, the courts may invalidate the agency's interpretation only if it is "unreasonable" or "impermissible." *Id.*

Investment Co. Institute v. Federal Deposit Ins. Corp., 815 F.2d 1540, 1546 (D.C.Cir.), *cert. denied*, 484 U.S. 847, 108 S.Ct. 143, 98 L.Ed.2d 99 (1987). *See also American Insurance Assoc. v. Clarke*, 865 F.2d 278, 280-81 (D.C.Cir.1988).

The Congress has not spoken clearly to what constitutes an unsafe or unsound practice, leaving the development of the phrase to the regulatory agencies. As we stated in *Groos Nat'l Bank v. Comptroller of Currency*, 573 F.2d 889, 897 (5th Cir. 1978), "[t]he phrase 'unsafe or unsound banking practice' is widely used in the regulatory statutes and in case law, and one of the purposes of the banking acts is clearly to commit the progressive definition and eradication of such practices to the expertise of the appropriate regulatory agencies." Thus, under the *Chevron* analysis, in the absence of clear congressional intent on the meaning of this language, we must examine the "reasonableness" and "permissibility" of the Board's interpretation that the failure of the holding company to inject capital into subsidiary banks is an "unsafe or unsound" practice.

In *Gulf Federal Sav. & Loan Ass'n v. Federal Home Loan Bank Bd.*, 651 F.2d 259 (5th Cir.1981), *cert. denied*, 458 U.S. 1121, 102 S.Ct. 3509, 73 L.Ed.2d 1383 (1982), the Federal Home Loan Bank Board found that Gulf Federal's contracting practice was an "unsafe or unsound" pracice within the meaning of § 1818. We disagreed and concluded that the FHLBB's finding that Gulf Federal's use of inconsistent contract terms was an unsafe or unsound practice was not a reasonable interpretation of the "unsafe or unsound practice" provision.

We also noted in *Gulf Federal* that the "unsafe or unsound practice" provision was the subject of lively congressional debate at the time the statute was enacted. We

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sidiary banks to some degree of financial soundness. The Federal Home Loan Bank Board (FHLBB) has long followed this practice in approving savings and loan holding company applications; in 1981, we approved the practice in *Kaneb Services, Inc. v. Federal Sav. & Loan Ins. Corp.*, 650 F.2d 78 (5th Cir. 1981). The statutory authority of the FHLBB to regulate savings and loan holding companies is practically identical to the authority granted the Board to regulate bank holding companies. *See* 12 U.S.C. §§ 1730(e)(1) and (3), 1730a(e)(2); Regulatory Capital Maintenance Obligations of Acquirers of Insured Institutions, 53 Fed.Reg. 31761 (1988); Acquisition of Control of Insured Institutions, 54 Fed.Reg. 32959 (1989) (to be codified at 12 C.F.R. § 574.7(a)(1) and (3)). The Office of Thrift Supervision, the successor to the FHLBB as primary regulator of savings and loan holding companies after FIRREA, continues this practice in its current regulations. *See* Transfer and Recodification of Regulations Pursuant to Financial Institutions Reform, Recovery and Enforcement Act, 54 Fed.Reg. 49411 (1989).

observed that the authoritative definition of an unsafe or unsound practice, adopted in both Houses, was that:

> Generally speaking, an "unsafe or unsound practice" embraces any action, or lack of action, which is contrary to generally accepted standards of prudent operation, the possible consequences of which, if continued, would be abnormal risk or loss or damage to an institution, its shareholders, or the agencies administering the insurance funds.

Id. at 264, *quoting* 112 Cong.Rec. 26474 (1966). *See* 112 Cong.Rec. 24984, 26474 (1966).

Enforcement of the Board's source of strength regulation requiring MCorp to transfer MCorp's funds to the troubled subsidiary banks can hardly be considered a "generally accepted standard[] of prudent operation." Such a transfer of funds would require MCorp to disregard its own corporation's separate status; it would amount to a wasting of the holding company's assets in violation of its duty to its shareholders. Also, one of the fundamental purposes of the BHCA is to separate banking from commercial enterprises. That purpose is obviously not served as merely an extension of its subsidiary bank.

Congress first under the BHCA in 1956 and later in amendments to the Federal Reserve Act in 1966 has generally defined with specificity the dealings between subsidiary banks and nonbank affiliates, including holding companies, it considered unsafe and unsound. *See* Bank Holding Company Act of 1956, c. 240, § 6, 70 Stat. 137, *repealed by* Pub.L. No. 89-485, § 9, 80 Stat. 240 (1966); Pub.L. No. 89-485, § 12(a) (amending 12 U.S.C. § 371c). *See also* S.Rep. No. 1179, 89th Cong., 2d Sess., *reprinted in* 1966 U.S.Code cong. & Admin.News 2394-96. Congress made no effort in any of this legislation to require holding companies to make capital injections into subsidiary banks as part of these safeguards. Congress noted only that the provision enacted

as part of the BHCA "does not prohibit the borrowing of funds by any subsidiary in the system from the parent bank holding company." S.Rep. No. 1095, 84th Cong., 1st Sess., *reprinted in* 1956 U.S.Code Cong. & Admin.News 2482, 2496. In sum, Congress set forth detailed limits on transactions considered unsound between subsidiary banks and holding companies, without mentioning the infusion of capital by holding companies into subsidiaries. This strongly supports MCorp's argument that Congress never intended to grant authority to the Board to require a holding company to inject capital into subsidiary banks as a safeguard against "unsafe or unsound" practices.

This is consistent with the conclusion reached by the Shadow Financial Regulatory Committee,[6] responding to the Board's source of strength policy. The Committee stated that, "while Congress has empowered regulators of banks to issue capital directives to institutions in their charge, it has not authorized the Fed to issue capital directives to bank holding companies." 48 Banking Rep. (BNA) No. 21, at 923 (May 25, 1987).

Thus, we conclude that the Board's determination that the holding company's failure to transfer its assets to a troubled subsidiary was an "unsafe or unsound practice" under §§ 1818(b)(1) and (3) is an unreasonable and impermissible interpretation of that term.

It is not our role to pass judgment on the wisdom of the scheme Congress put in place to regulate bank holding companies. Similarly, the Board cannot exceed the authority Congress granted to it to correct perceived flaws in the congressional scheme. As the Supreme Court stated in *Dimension Financial:*

> The statute may be imperfect, but the Board has no power to correct flaws that it perceives in the stat-

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[6] Formed in February 1986, the Shadow Financial Regulatory Committee (SFRC) meets periodically to monitor regulation of the financial services industry. The SFRC is composed of economists, academics and former financial regulators.

ute it is empowered to administer. Its rulemaking power is limited to adopting regulations to carry into effect the will of Congress as expressed in the statute.

If the Bank Holding Company Act falls short of providing safeguards desirable or necessary to protect the public interest, that is a problem for Congress, and not the Board or the Courts, to address.

474 U.S. at 374, 106 S.Ct. at 688-689 (footnote omitted).[7]

III.

Because we find that the Board's source of strength proceedings exceed its statutory authority, we remand this case to the district court with instructions to enjoin the Board from further prosecution of this charge. The remaining preliminary injunction entered by the district court is vacated because it lacked subject matter jurisdiction to interfere with the Board's § 23A proceedings.

REVERSED, VACATED and REMANDED.

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[7] The Board also asserts on appeal that its administrative proceedings are exempt from both the Bankruptcy Code's automatic stay provision, 11 U.S.C. § 362(b) and the general equitable power of the bankruptcy court under § 105 of the Code. Because we find that the district court, sitting in bankruptcy, lacks jurisdiction over the Board's ongoing enforcement actions, we need not address MCorp's argument that the Bankruptcy Code's stay provisions prevent the Board from proceeding.

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF TEXAS
HOUSTON DIVISION

Civ. A. No. 89-1677
Bankruptcy No. 89-02312-H3-11
Adv. No. 89-0298

IN RE MCORP, MCORP FINANCIAL, INC.,
AND MCORP MANAGEMENT, DEBTORS

MCORP, MCORP FINANCIAL, INC., AND MCORP MANAGEMENT, DEBTORS IN POSSESSION, PLAINTIFFS, AND OFFICIAL CREDITORS' COMMITTEE, INTERVENOR

v.

THE BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM OF THE UNITED STATES OF AMERICA, DEFENDANT

[Filed: June 19, 1989]

OPINION ON THE PRELIMINARY INJUNCTION AGAINST THE FEDERAL RESERVE SYSTEM

HUGHES, *District Judge.*

1. *Introduction.*

As debtor in possession, a bank holding company and two of its nonbank subsidiaries (MCorp, MCorp Financial, Inc., and MCorp Management [Debtor]) applied for

a preliminary injunction against the Board of Governors of the Federal Reserve System (Board). The Debtor seeks to enjoin the Board from prosecuting administrative proceedings against the holding company and its nonbank subsidiaries as part of the Board's regulation of the safety and integrity of the bank subsidiaries. The issue is whether a nonbank corporation that owns banks and nonbanks as subsidiaries is entitled to have its bankruptcy case principally directed by the banking agencies or by the bankruptcy process. An injunction will be issued to allow possible reorganization of the Debtor through the bankruptcy court.

2. *Statutes.*

The Debtor asserts:

A. This court sitting in bankruptcy has exclusive jurrisdiction over all the property in the debtor's estate. 28 U.S.C. § 1334(d);

B. The Board's actions are in reality an attempt to control the assets of the estate in violation of the automatic stay. 11 U.S.C. § 362(a).

C. If the Board is exempt from the automatic stay, the bankruptcy code authorizes an injunction to protect the debtor from third-party interference. 11 U.S.C. § 105.

The Board counters:

A. The Financial Institutions Supervisory Act (FISA) withdraws jurisdiction from the courts, superseding the automatic stay imposed by the bankruptcy code. 12 U.S.C. § 1818(i).

B. The Board's proceedings are regulatory actions exempted from the automatic stay. 12 U.S.C. § 1818(b); 11 U.S.C. § 362(b).

C. The character of the regulation and the general scheme of banking supervision are not the third-

party acts that should be subject to an injunction against interference with a bankruptcy case.

3. *Background of the Controversy.*

At the beginning of 1989, MCorp was a bank holding company, owning twenty-five bank subsidiaries and several nonbank subsidiaries. In common with many financial institutions, MCorp has suffered large, continuing losses from its real estate loans, having already written down its bad oil-related loans. In March, the comptroller of the currency declared twenty of MCorp's banks insolvent and closed them. The banks continued to operate as nationalized receiverships through the Federal Deposit Insurance Corporation under the name Deposit Insurance Bridge Bank.

This civil action was an adversary proceeding in the consolidated bankruptcy case to reorganize MCorp, and the reference by the district court to the bankruptcy court was withdrawn. (Adversary Number 89-0298.) The other actions are:

A. An involuntary petition was filed in the Southern District of New York against MCorp and it was transferred here to pend under Case Number 89-02848-H2-11.

B. A voluntary petition was filed in the Southern District of Texas by MCorp Management under Case Number 89-02324-H5-11.

C. A voluntary petition was filed in the Southern District of Texas by MCorp Financial, Inc., under Case Number 89-02312-H3-11.

The filing in New York of the involuntary case precipitated the bank closing by the comptroller and the voluntary cases by the subsidiaries. The Official Creditors' Committee of the debtors was allowed to intervene to assert essentially the same grounds as MCorp in support of an injunction.

MCorp is left with five bank subsidiaries and all of its nonbank subsidiaries, two of which are also debtors in bankruptcy. MCorp maintains that twelve of its banks were closed illegally or improvidently. The closed institutions are not under the control of MCorp because they are under FDIC receiverships.

The Federal Reserve Board has initiated administrative actions against MCorp as a bank holding company for violating its regulations that ensure the integrity of the banking system through the requirement that the holding company be a "source of financial strength" to the subsidiary banks. The administrative actions will conflict with MCorp's ability to address a global reorganization in the bankruptcy case.

4. *Standard for Injunctive Relief.*

This proceeding is in the nature of a preliminary declaratory judgment rather than a normal preliminary injunction which maintains some status between principal litigants until the merits of their claims have been heard. This injunction will prospectively assign one authority or another to supervise a restructuring.

Despite the peculiar nature, this injunction meets the regular requirements. *Canal Auth. v. Callaway*, 489 F.2d 567, 572 (5th Cir.1974).

A. MCorp is likely to prevail on the merits of its legal priority claim. The automatic stay is applied rigorously, and only in exceptional cases is there a departure from protecting the debtor. Where the regulation is inextricably mixed with the restructuring process rather than some ancillary public health or safety question, MCorp ought to succeed with its claim of insulation from the Board by the automatic stay. Even if the regulatory exemption applies, the highly probable result is MCorp's success because of the availability of the anti-interference protection.

B. Enjoining the Board is necessary to prevent imminent and irreparable harm to the Debtor; responding to the Board's proceedings deprives MCorp of resources desperately needed to prepare for its reorganization. If MCorp is to survive, to the benefit of the creditors and the government, it must act quickly, for a lingering Chapter 11 case inevitably becomes a liquidation. Obliging MCorp to respond in multiple forums to multiple agencies, each with its own internal and external priorities, would dissolve the focus MCorp needs to see the route to survival.

C. The risk to MCorp in both probability and magnitude exceeds the possible danger to the Board's interests. The safeguards of the bankruptcy code ensure the protection of the generalized interest of the Board in healthy holding companies. The Board's exposure to liability independent of its regulatory concern is minimal, and it is not jeopardized by this injunction. Its interest can adequately be represented in the bankrupcy proceedings.

D. The issuance of this injunction does not harm the public interest defined either as the general public interest or as the discernible interests of unrepresented third-parties. To the contrary, the public is served by having all proceedings in one forum, especially a forum where the individuals in the affected public can participate.

5. *Issue.*

When a bank holding company seeks reorganization under the bankruptcy code, does the general bankruptcy process supersede the processes of the agencies that regulate banking?

6. *Regulatory Framework.*

A. *Comptroller of the Currency.*

General supervision of national banks, including their creation and closing, is confided to the comptroller of the currency. If, on his examination, the comptroller determines that a bank is insolvent, he places it in receivership. That receiver is the FDIC. 12 U.S.C. § 191.

B. *Federal Deposit Insurance Corporation.*

The FDIC has two roles in banking regulation. First, it acts as a limited insurer of deposits to attract depositors to the banking system and to prevent runs, with their destructive effects. Second, the FDIC acts as a receiver for the estate of a bank that has been closed by the comptroller. 12 U.S.C. § 1811.

C. *Federal Reserve Board.*

The Federal Feserve System is the central bank for the United States, and among its powers are responsibilities for the regulation of banks and bank holding companies. The Board's regulation takes many forms, like its clearinghouse function, furnishing liquidity, margin and capital requirements, open market purchases and sales, and currency issuance.

Under the FISA, if the Board finds that a bank holding company has engaged in an unsafe or unsound practice, the Board has the authority to notify the company of its charges, stating the violations and setting a hearing before the Board. 12 U.S.C. § 1818(b). If the charges are proved, the Board can order the company to stop the derelict practices and to take affirmative steps to prevent future violations.

Temporary orders to desist may also be issued by the Board before proceedings are completed.

These orders may be issued without a hearing and are effective immediately.

Because the purpose of vesting the Board with these powers is to assure the soundness of banks that are owned by holding companies, transactions between the parent company and its nonbank subsidiaries may be regulated to prevent losses to the bank subsidiaries.

7. *Classes of Regulation by the Board.*

The Board has claimed four classes of authority over the Debtor and its components. First, the Board is empowered to regulate the banking process, through its clearinghouse function, for example.

Second, the most obvious class of power that the Board has over banks is through its central bank functions. These directly affect the parties here, through reserve and margin requirements for instance, but they are fashioned at a higher level than individual bank operation. These are not involved; the bank subsidiaries of MCorp will continue to abide by the Board's general regulation of banking transactions.

Third, the Board is charged generally with supervision of bank and bank holding company practices that may endanger the integrity of the banks and the system of banks. These vaguely defined powers cover items from the requirement of minimum capital to the prohibition of self-dealing.

Fourth, the Board asserts the authority to direct the activities of the holding company's nonbank subsidiaries in their transactions unrelated to banks or banking including forcing a sale for capital infusion.

8. *Priority of Regulation.*

Banks cannot file for bankruptcy; they must reorganize or liquidate under the banking laws. Bank holding companies, however, are not prohibited from recourse to bankruptcy, and while they are regulated by banking

agencies, they cannot be reorganized or liquidated under the laws for banks. Congress has amended both the banking and the bankruptcy laws several times, never resolving this potential conflict.

The new bankruptcy code was adopted in 1978, long after bank holding companies had been regulated. The holding company act has been frequently amended itself. The dual nature of bank holding companies implicates the interests of the systems both of regulation and of reorganization. The statutes as enacted limit the bank regulators to primacy in dealing with banks.

When a bank holding company is a debtor in possession, the conflict between the court's restructuring of the corporation and the Board's regulating can be resolved by allowing the Board to participate in the court proceeding. Preclusion by the bankruptcy forum would not cover the Board's clearinghouse or monetary functions, but it would restrict the Board's supervision of MCorp's asset allocation, intra-group transactions, and third-party contracts. This would give the Debtor the reprieve needed to retrieve its vitality.

Allowing the Board's proceedings to continue in a separate forum poses several problems. Parrallel proceedings are both confusing and inefficient. The potential for a successful reorganization would be jeopardized. The bankruptcy code is designed to be a comprehensive plan to rehabilitate the debtor to the exclusion of actions impairing reorganization.

Without minimizing the importance of the Board's administrative power over bank holding companies, the need for the court's power over the entirety of the debtor's estate takes precedence. This preemption is supported by policy and law.

Financial Institutions Supervisory Act, 12 U.S.C. § 1818(i), says:

> [N]o court shall have jurisdiction to affect by injunction or otherwise the issuance or enforcement of any notice or order under this section, or to review, modify, supend, terminate, or set aside any such notice or order.

Similar jurisdictional limitations have been overridden through control of the debtor's estate having been entrusted to the authority of the bankruptcy court. This construction has been employed in cases affecting the Court of Claims and the Tax Court (both administrative rather than judicial); their jurisdictional grants are parallel to the Board's and distinct from the judicial power through the bankruptcy code. *See re Casey Corp.*, 46 B.R. 473 (Bankr.S.D.Ind.1985); *Bostwick v. United States*, 521 F.2d 741 (8th Cir. 1975).

The *in rem* proceedings in admiralty, which are particular liquidation actions, yield to the bankruptcy code's plan for general liquidation. This is true even though maritime jurisdiction is directly a judicial power of international significance. *In re Louisiana Ship Management, Inc.*, 761 F.2d 1025 (5th Cir.1985). The grant of jurisdiction over the debtor's estate for the restricted purpose of facilitating the reorganization of the debtor supersedes other jurisdictional limits. 28 U.S.C. § 1334(d).

9. *Regulatory Exception to the Stay.*

Even if the principal power over the debtor's estate is in the bankruptcy court, agencies whose mandate includes matters of "police or regulatory power" are not barred by the filing of a petition from pursuing the debtor. 11 U.S.C. § 362(b)(4). Although very few imaginable acts of a governmental unit could not plausibly be claimed to be within that category, congress did not act to exempt all governmental actions from the automatic stay, for the phrase "police and regulatory power" is a peculiar way to say "all."

A. There are two tests usually articulated in deciding whether the stay applies to a governmental action. Although neither of these dichotomies is particu-

larly applicable with precision, they both do recognize that there are automatically stayed government activities.

(1) The first divides governmental actions into two categories: pecuniary interest of the state in the debtor's estate or public policy affecting safety and health.

(2) The second divides governmental actions into two slightly different categories: those that adjudicate private rights and those that effectuate public policy. *See N.L.R.B. v. Edward Cooper Painting, Inc.*, 804 F.2d 934, 942 (6th Cir. 1986).

B. A solution to the definitional problem can be reached on procedural grounds. The principal difference between the automatic stay and the anti-interference injunction is the burden on the participants. For ordinary acts against the debtor's property, the stay has minimal risk to those who are blocked or the public. Because the automatic stay of private acts against the debtor's estate covers the majority of the debtor's relations, it has enough relief to allow reorganization. For governmental acts (as well as third-parties) to be blocked, however, the debtor must identify and move against them specifically through an injunction. The effect of this reading would produce a clear and reasonable approach, but it would still be an alteration of the plain text of the statute.

C. One solution to the lack of precision in the clause that allows some escape by governments from the stay is to attempt to classify governmental actions between those that are of immediate, actual concern to the health of the general public and those that are assists to private parties, asset allocations, and property acquisitions for its own account, as they are at cross purposes with the federal reorganization powers.

The Board's interest in protecting the public from "unsafe" banking practices may be important, but it does not rise to the level of injury or immediacy of aircraft certification, adulterated foods, or transportation of diseased livestock. 12 CFR 225, Reg. Y. In a case involving the Environmental Protection Agency, a court of appeals has said that the scope of the exemption from the stay is not limited to matters of imminent physical peril; however, the case dealt with a landfill without several safeguards, including a prevention of polluted runoff, so the comment was an observation, not a holding. *Matter Commonwealth Oil Refining Co., Inc.*, 805 F.2d 1175 (5th Cir.1986) *cert. denied sub nom. Commonwealth Oil and Refining Co. v. E.P.A.*, 483 U.S. 1005, 107 S.Ct. 3228, 97 L.Ed.2d 734 (1987). Notably, the legislative history of the code reveals that bankruptcy courts have been enforcing the automatic stay against state pollution abatement efforts. *See* HR Rep. No. 95-595, 95th Cong., 1st Sess., 174-5 (Bankruptcy Reform Act of 1978), U.S. Code Cong. & Admin. News 1978, pp. 5787, 6134, 6135.

One court has held that access to assets that are necessary to the business's future vitality are exempt regulatory matters, and not even property of the debtor's estate since the assets were useful only through further regulation. *In re Braniff Airways*, 700 F.2d 935 (5th Cir.1983) (landing slots necessary for reorganization were not subject to bankruptcy court orders over FAA).

On the other hand, there are cases restricting the exemption from the stay to matters directly affecting the public safety, which should not be interrupted pending a hearing to lift the stay. Others have held that some parallel proceedings, like competing license applications, that might require some distraction to the debtor's reorganization efforts are not stayed through the exemption even though they do not involve palpable health hazards. *See Jordan v. Randolph Mills, Inc.*, 716 F.2d 1053 (5th Cir.1983); *In re D.H. Overmyer Telecasting Co., Inc.*, 35 B.R. 400 (Bankr.N.D.Ohio 1983).

10. *Governmental Actions Not Excepted from the Stay.*

Ignoring the distinction between "all" and "police-regulatory" is easy and wrong; by the plain terms of the statute there are governmental actions that are not exempted from the stay. To determine whether a governmental function is among those that should be exempt, the court must evaluate the function of the regulation, the probability of direct public harm, the opportunity for the public interest to be effectively represented in the bankruptcy proceeding, and the relation between the regulation and the financial, legal, and structural requirements for an effective reorganization. *See In re King Memorial Hospital, Inc.*, 4 B.R. 704 (Bankr.S.D.Fla. 1980); *In re Joe DeLisi Fruit Co.*, 11 B.R. 694 (Bankr. D.Minn. 1981).

Both the Board's generalized, diffuse interest in the holding company as well as the duplicative, distracting hearings militate for its being not exempt from the stay.

11. *Reorganization by Subterfuge.*

MCorp argues that the current state of regulatory orders issuing from the Board is effectively an attempt by the Board to control the estate of the Debtor for the purpose of dictating MCorp's future structure. While this appears plausible, it is unnecesary to address it in detail because the stay applies to most of the regulation and because the Board is subject to the anti-interference prohibition. 11 U.S.C. § 105.

The bankruptcy court can scrutinize the potential for undisclosed motivations when the Board presents a motion to lift the stay.

12. *Anti-Interference Authority.*

Whatever the role of the automatic stay, the bankruptcy code authorizes an injunction against third parties from conducting otherwise fully legitimate actions when those actions would impede the viability of the debtor's reorganization. The Board claims an exemption

from the anti-interference power parallel to the regulatory exemption from the automatic stay. Virtually any company is subject to a variety of regulatory agencies, and no reorganization would be possible without requiring the federal, state, and local authorities to submit their claims through the bankruptcy process. Securities issued as a consequence of a bankruptcy supervised reorganization are expressly exempt from the registration requirements of the Securities and Exchange Commission. 11 U.S.C. § 1145.

The court shares the Board's concern that the laudable but limited purposes of bankruptcy not be perverted into an escape from regulation. The bankruptcy process includes a vigilant, fully empowered judge who will prevent individual or collusive efforts to evade the Debtor's responsibilities to the public.

The Board's interest in MCorp, as distinct from the comptroller or FDIC's interest in the banks, is secondary and diffuse. The overlapping authority between bank regulators and bankruptcy courts is resolved in favor of the court. As an example, when responding to a receivership imposed by a district court under the Securities and Exchange Commission's authority, it has been said that "to the extent that the exercise of this jurisdiction threatens the assets of the debtor's estate, the bankruptcy court may issue a stay of those proceedings." *Securities & Exch. Comm'n v. First Fin. Group of Texas*, 645 F.2d 429, 440 (5th Cir. 1981).

13. *Conclusion.*

While the operation of the banking system under the guidance of the Board is an important interest, congress has also recognized the importance of allowing debtors to restructure so that they may make a contribution to the economic vitality of the country. Under the circumstances of a bank holding company with nonbank subsidiaries, accommodation of the two national interests in bankruptcy and banking requires that the bankruptcy

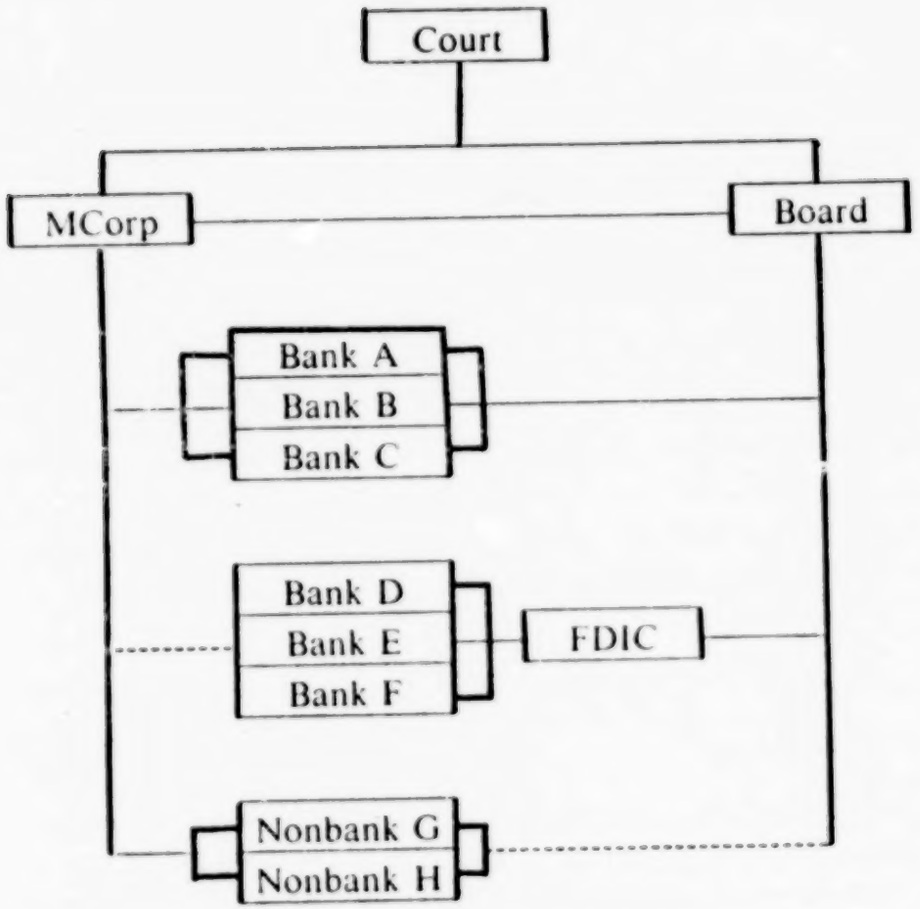
court have primacy over the non-operations aspects of the debtor and that the Board, after participating, abide by the capital allocation and structural aspects of the debtor as determined in the bankruptcy rather than conducting its independent actions.

The court is mindful that a debtor that follows MCorp's precedent may attempt to abuse the opportunity furnished by the bankruptcy code, but the principle here is clear, and it must be applied with care, even here. The court is also mindful of who was paid to prevent the bank practices that resulted in the collapse of the system in the Southwest. Neither side has an occasion for self-righteousness.

The Board will be enjoined to allow the claims in its pending charges to abate, except through the bankruptcy court.

Signed on June 19, 1989, at Houston, Texas, correcting case numbers and descriptions in the "Background of the Controversy" section of the opinion of June 9, 1989.

APPENDIX A



A-C represent remaining subsidiary banks.

D-F represent subsidiary banks declared insolvent.

G-H represent nonbank subsidiaries.

PRELIMINARY INJUNCTION AGAINST THE FEDERAL RESERVE SYSTEM'S PROCEEDING ADMINISTRATIVELY AGAINST MCORP

1. *Parties.*

A. The parties plaintiff are:

(1) MCorp, a bank holding company;

(2) MCorp Financial, Inc., a non-bank subsidiary of MCorp; and

(3) MCorp Management, a non-bank subsidiary of MCorp.

(4) Each of the plaintiffs are debtors in possession (MCorp collectively).

B. The Official Creditors Committee formed under the bankruptcy statutes has been allowed to intervene.

C. The party defendant is the Board of Governors of the Federal Reserve System of the United States (Board).

2. *Related Proceedings.* This civil action was an adversary proceeding in the consolidated bankruptcy case to reorganize MCorp. and the reference by the district court to the bankruptcy court was withdrawn. (Adversary Number 89-0298.) The other actions are:

A. An involuntary petition was filed in the Southern District of New York against MCorp, and it was 89-02848-H2-11.

B. A voluntary petition was filed in the Southern District of Texas by MCorp Management under Case Number 89-02324-H5-11.

C. A voluntary petition was filed in the Southern District of Texas by MCorp Financial, Inc., under Case Number 89-02312-H3-11.

D. The three bankruptcy actions have been consolidated under the earliest case number for joint administration.

3. *Reasons.* The court finds these to be reasons to grant injunctive relief:

A. The allocation of power to supervise bank holding companies conflicts when the corporation has sought protection under the bankruptcy statutes, and the conflicts can be minimized only through the intervention of the court.

B. The waste and confusion attendant upon parallel bankruptcy and administrative proceedings would defeat the legislative expectation of both sets of statutes, harm irreparably the estates of the bankrupts and their creditors (including the various governmental claims), escalate transaction costs by duplication and conflict, and protect no public interest or governmental function not fully addressable in the bankruptcy proceeding.

C. Prevalence on the merits in this case appears to be reduced to a correct interpretation of which public forum has precedence when a bank holding company has subsidiaries that include non-banks; however, MCorp is likely to prevail on its claim that the executive's administrative power over bank holding companies is preempted by the bankruptcy power which congress has confided to the judiciary.

D. Neither an interest of the public nor an interest of a group of nonparties will be harmed by this injunctive solution to the regulatory conflict.

4. *Restraint.* It is decreed that:

A. The Board is preliminary enjoined from prosecuting:

(1) Notice of Charges dated October 19, 1988;

(2) Amended Notice of Charges dated October 26, 1988;

(3) Notice of Charges dated March 30, 1989, and;

(4) Second Amended Notice of Charges dated May 24, 1989, issued by the Board to MCorp, and

B. The Board is preliminarily enjoined from enforcing the temporary desist orders issued by the Board to MCorp dated October 19, 1988, and October 26, 1988.

C. The Board may continue its general execution, supervisory, and examination duties of the operations of MCorp and its bank subsidiaries and may continue its central bank duties as they affect MCorp in common with all other institutions.

D. The Board is enjoined from using its authority over bank holding companies or banks to attempt to effect, directly or indirectly, a reorganization of the MCorp group or its components or to interfere, except through participation in the bankruptcy proceedings, with the restructuring being developed in the bankruptcy proceeding.

E. The restraint of this order is effective against the governors, the Federal Reserve System, its employees, its agents, and those acting in concert with them; however, the restraint does not apply to parallel agencies of the government like the Comptroller of the Currency or the Federal Deposit Insurance Corporation as they may independently pursue their regulatory mandates.

5. *Prospective Board Actions.*

A. The Board shall present proposed new administrative proceedings by it against MCorp or the proposed issuance of new notices of charges or new temporary desist orders to MCorp.

B. If the parties cannot agree that the subject of the new proceeding is within the category of regulation exempted from this injunction, then the proposed action shall be presented to this court to determine whether it is an operational issue for the Board or an asset-structural issue for the bankruptcy court.

6. *Further Proceedings.*

A. Under emergency scheduling, the parties may seek modification of this order after notice to the parties.

B. The trial will not be set until the bankruptcy court has had a reasonable opportunity to address the issues raised by MCorp having subsidiaries banks and non-banks.

C. A status conference is set for:

August 15, 1989
10:00 a.m. Tuesday

Signed on June 19, 1989, at Houston, Texas, correcting case numbers and descriptions in the "Related Proceedings" section of the judgment rendered on June 2, 1989, and signed June 3, 1989.

UNITED STATES OF AMERICA
BEFORE THE BOARD OF GOVERNORS
OF THE FEDERAL RESERVE SYSTEM
WASHINGTON, D.C.

No. 88-062-B-HC

IN RE MCORP, DALLAS, TEXAS

[Filed: Oct. 19, 1988]

NOTICE OF CHARGES AND OF HEARING ISSUED PURSUANT TO THE FEDERAL DEPOSIT INSURANCE ACT, AS AMENDED, AND THE BANK HOLDING COMPANY ACT OF 1956, AS AMENDED

The Board of Governors of the Federal Reserve System (the "Board of Governors") has reasonable cause to believe that MCorp, Dallas, Texas ("MCorp"), a registered bank holding company, has engaged, is engaging and, unless restrained, will continue to engage in unsafe and unsound practices in conducting the business of MCorp, and that, as a result of the unsafe and unsound practices, the financial condition of MCorp and its subsidiary banks are likely to be adversely affected.

Accordingly, the Board of Governors hereby institutes this proceeding for the purpose of determining whether an appropriate order to cease and desist should be issued against MCorp and issues this Notice of Charges and of Hearing (the "Notice") in implementation thereof pursuant to the provisions of sections 8(b)(1) and 8(b)(3) of the Federal Deposit Insurance Act, as amended (the "Act") (12 U.S.C. 1818(b)(1) and (3)), section 5(b) of the Bank Holding Company Act of 1956, as amended (the "BHC Act") (12 U.S.C. 1844(b)) and the Board of Governors' Rules of Practice for Hearings (12 CFR Part 263).

In support of this Notice, the Board of Governors alleges the following:

1. MCorp, a corporation existing and doing business under the laws of the State of Delaware and Texas, is and has been at all times pertinent to the charges herein a registered bank holding company. MCorp, therefore, is and has been at all times pertinent to the charges herein subject to the Act (12 U.S.C. 1818 *et seq.*), the BHC Act (12 U.S.C. 1841 *et seq.*) and the rules and regulations of the Board of Governors (12 CFR 201 *et seq.*).

2. As of the date of this Notice, MCorp owns 26 subsidiary banks and 17 active nonbank subsidiaries (referred to herein collectively as the "Subsidiary Banks" and the "Nonbank Subsidiaries", respectively), and, by virtue of such ownership, controls the affairs and management of the Subsidiary Banks and the Nonbank Subsidiaries.

3. The conditions of MCorp and its Subsidiary Banks and Nonbank Subsidiaries have been deteriorating, and the MCorp organization is currently in extremely poor condition, with a large volume of nonperforming assets, inadequate levels of capital protection, opearting losses and insufficient reserves for the kind and quality of its problem assets. In particular:

(a) For the year ending December 31, 1985, MCorp reported that, on a consolidated basis, nonperforming assets were $534 million or 3.5 percent of the organization's total loans and leases. For the year ending December 31, 1986, consolidated nonperforming assets had risen to $1.2 billion or 7.6 percent of MCorp's total loans and

leases. For the year ending December 31, 1987, nonperforming assets on a consolidated basis stood at $1.6 billion or 11.5 percent of the organization's total loans and leases. By the end of the second quarter of 1988, as of June 30, 1988, consolidated nonperforming assets had increased to $1.8 billion or 13.7 percent of total consolidated loans and leases.

(b) (1) For the year ending December 31, 1985, MCorp's consolidated equity capital stood at 5.7 percent of the organization's consolidated total assets. For the year ending December 31, 1986, the company's consolidated equity capital was 5.2 percent of its consolidated total assets. For the year ending December 31, 1987, MCorp's consolidated equity capital had decreased to 4.2 percent of its consolidated total assets. As of the second quarter of 1988, ending June 30, 1988, the organization's equity capital had declined further to 4.1 percent of its total assets. MCorp's tangible primary capital, on a consolidated basis, at the end of the second quarter of 1988, ending June 30, 1988, stood at 5.4 percent of its adjusted total tangible assets.

(2) As of September 30, 1988, the Board of Governors has reasonable cause to believe that (i) MCorp's consolidated equity capital deteriorated further and stood at approximately 1.5 percent of the organization's consolidated total assets, and (ii) MCorp's consolidated equity capital, excluding intangible assets, stood at 0.2 percent of its total tangible assets.

(c) For the year ending December 31, 1985, MCorp reported, on a consolidated basis, net income of $132 million. For the year ending December 31, 1986, MCorp reported, on a consolidated basis, net losses of $82 million. For the year ending December 31, 1987, MCorp reported, on a consolidated basis, net losses of $258 million. For the first half of 1988, ending June 30, 1988, MCorp had a one-time, extraordinary gain in excess of $200 million on the sale of the controlling interest of a nonbank subsidiary, but, because of significant operating

losses, reported consolidated net losses of $12 million. The Board of Governors has reasonable cause to believe that MCorp suffered consolidated losses for the third quarter of 1988 of approximately $525 million, thereby reporting year-to-date net consolidated losses of approximately $537 milion as of September 30, 1988.

(d) As of December 31, 1986, MCorp reported, on a consolidated basis, that the organization's reserves for loan losses were 37.5 percent of the organization's nonperforming loans. As of December 31, 1986, the reserves for loan losses of the 50 largest bank holding companies in the United States, which included MCorp, averaged 114 percent of nonperforming loans. As of December 31, 1987, MCorp reported, on a consolidated basis, that the organization's reserves for loan losses were 25.2 percent of the organization's nonperforming loans. As of December 31, 1987, the reserves for loan losses of the 50 largest bank holding companies in the United States, including MCorp, average 112 percent of nonperforming loans. As of June 30, 1988, MCorp reported, on a consolidated basis, that the organization's reserves for loan losses were 22.8 percent of the organization's nonperforming loans. As of June 30, 1988, the reserves for loan losses of the 50 largest bank holding companies in the United States, including MCorp, averaged over 100 percent of on performing loans.

(e) On October 7, 1988, MCorp requested that the Federal Deposit Insurance Corporation provide MCorp with federal assistance pursuant to section 13(c) of the Act (12 U.S.C. 1823(c)).

4. (a) As a result of the conditions described in paragraph 3 hereof, *i.e.*, the extraordinary high volume of poor quality and nonperforming assets, the conditions of the Subsidiary Banks have deteriorated to critical levels. In particular:

(1) The Minimum Capital Ratios Regulation of the Office of the Comptroller of the Currency (the "OCC") (12 CFR Part 3) provides that the minimally acceptable

ratio of primary capital to total assets for national banking institutions in the soundest and strongest financial conditions is 5.5 percent. The OCC's capital regulation further provides that national banks in unsatisfactory conditions, such as the majority of the 25 Subsidiary Banks that are nationally chartered, are expected to hold additional capital adequate to compensate for their higher levels of risks. The Subsidiary Banks that are national banks, in accordance with the OCC's regulation, are required to maintain capital in excess of the minimally acceptable ratio of 5.5 percent of total assets.

(2) As of June 30, 1988, 20 of the Subsidiary Banks, which represented 78.8 percent of MCorp's total bank assets, had primary capital of less than 5.5 percent of each bank's total assets.

(b) As of the date of this Notice, the Board of Governors has reasonable cause to believe that MCorp's third quarter 1988 losses of about $525 million further depleted the Subsidiary Banks' primary capital, thereby increasing the Subsidiary Banks' capital shortfall well below minimally acceptable capital levels.

5. As of June 30, 1988, the MCorp parent group, which excludes the Subsidiary Banks, had total assets, exclusive of investments in the Subsidiary Banks, in excess of $400 million. As of the date of this Notice, a significant portion of these assets are readily available to be used to fund direct capital contributions to those Subsidiary Banks experiencing capital deficiencies.

6. MCorp and its management have engaged, are engaging, and, unless restrained, will continue to engage in unsafe and unsound practices that have weakened and will continue to weaken seriously the condition of MCorp and the Subsidiary Banks and are likely to cause substantial dissipation of the assets of MCorp that could be used to allow MCorp to serve as a source of financial strength for the Subsidiary Banks. In particular:

(a) (1) Section 5(b) of the BHC Act (12 U.S.C. 1844(b)) provides that:

> The Board is authorized to issue such regulations and orders as may be necessary to enable it to administer and carry out the purpose of this chapter [the BHC Act] and prevent evasions thereof.

(2) Section 225.4(a)(1) of Regulation Y of the Board of Governors (12 CFR 225.4(a)(1)) provides that:

> A bank holding company shall serve as a source of financial and managerial strength to its subsidiary banks and shall not conduct its operations in an unsafe or unsound manner.

(3) Under the provisions of law and regulation set forth in paragraphs 6(a)(1) and (2) hereof, a bank holding company, in accordance with Board policy, should use its available resources to provide adequate capital funds to its subsidiary banks, particularly in the event that such assistance is necessary to prevent the deterioration or the failure of any of its subsidiary banks.

(4) As described in paragraph 5 hereof, the MCorp parent group has available assets that could be used where appropriate to fund direct capital contributions to those Subsidiary Banks experiencing capital shortfalls.

(5) By letter dated August 24, 1988, a shareholder and creditor of MCorp advised MCorp that, in its view, MCorp has a duty to preserve sufficient liquid assets and other assets to enable MCorp to pay its debts and dividends on its outstanding preferred stock and that MCorp should not make what the shareholder or creditor believed to be unrecoverable investments in its Subsidiary Banks.

(6) The Board of Governors has reasonable cause to believe that, unless restrained, MCorp and its management in response to pressure from shareholders and creditors will fail to maintain current assets at the parent company level that could be used, where appropriate, to provide adequate capital to the Subsidiary Banks in order to prevent the parent company from becoming a financial drain and to prevent the deterioration of such

banks and thereby will engage in an unsafe and unsound banking practice and a violation of section 225.4 (a)(1) of Regulation Y of the Board of Governors and that would limit MCorp's ability to serve as source of financial strength to the Subsidiary Banks.

(b) MCorp and its management have engaged in unsafe and unsound dividend practices by using funds to pay cash dividends at a time when the severe financial condition of the Subsidiary Banks warranted capital injections. In particular, for the year ending December 31, 1986, MCorp paid cash dividends on its common stock and preferred stock of approximately $45 million and $11 million, respectively. For the year ending December 31, 1987, MCorp paid cash dividends on its preferred stock of approximately $14 million. During the first three quarters of 1988, ending September 30, 1988, MCorp has paid and/or declared cash dividends on its preferred stock of approximately $12 million. A cash dividend on MCorp's preferred stock in the amount of $840,000 was paid on October 14, 1988, and, unless restrained, additional cash dividends on preferred stock in the approximate amount of $2.0 million will be paid by MCorp on October 25 and November 1, 1988. These cash dividends were paid and would be paid to shareholders in years when MCorp reported operating losses, as described in paragraph 3(c) hereof, in contravention of the Board of Governors Policy Statement on the payment of cash dividends by bank holding companies, issued November 14, 1985 (F.R.R.S. 4-877). Moreover, these cash dividends were paid out to shareholders in years when, as described in paragraphs 3(b) and 4 hereof, the capital of the Subsidiary Banks and MCorp deteriorated below minimally accepted levels and MCorp failed to inject adequate amounts of new capital into the Subsidiary Banks.

7. (a) MCorp and its management have failed to operate MCorp, the Subsidiary Banks and the Nonbank Subsidiaries in a safe, sound and lawful manner as set forth in paragraphs 3, 4, 5 and 6 hereof.

(b) MCorp and its management have engaged, are engaging and, unless restrained, will continue to engage in the unsafe and unsound practices set forth in paragraphs 3, 4, 5 and 6 hereof. In particular, the Board of Governors has reasonable cause to believe that MCorp will not take the actions that are necessary (1) to prevent the substantial dissipation of corporate assets through cash dividends, and (2) to maintain and prevent the dissipation of available resources at the parent company level that could be used, where appropriate, to make immediate capital injections into the Subsidiary Banks.

8. Notice is hereby given that a hearing will be held on December 12, 1988 at the Federal Reserve Bank of Dallas for the purpose of taking evidence on the charges hereinbefore specified in order to determine whether an appropriate order should be issued under the Act and the BHC Act requiring MCorp to cease and desist from the unsafe or unsound practices herein specified or to take affirmative action to correct the conditions resulting from such unsafe or unsound practices. Appropriate corrective action may include the issuance of a cease and desist order:

(a) Prohibiting the payment of all cash dividends;

(b) prohibiting the dissipation of parent group assets that could be used to fund capital injections into the Subsidiary Banks, except for the payment of debts in accordance with contractual obligations, corporate salaries and operating expenses; and

(c) such other affirmative actions as may be appropriate under the circumstances of this matter.

9. The hearing referred to in paragraph 8 hereof shall be held before an administrative law judge to be appointed by the United States Office of Personnel Management pursuant to section 3344 of Title 5 of the United States Code (5 U.S.C. 3344). The hearing shall be private, unless the Board of Governors shall determine that a public hearing is necessary to protect the

public interests, and in all other aspects shall be conducted in compliance with the provision of the Act and the Board of Governors' Rules of Practice for Hearings.

10. Authority is hereby delegated to the Secretary of the Board of Governors to designate the time and place and presiding officer for any hearing that may be conducted on this Notice and take any and all actions that the presiding officer would be authorized to take under the Board of Governors' Rules of Practice for Hearings with respect to this Notice and any hearing to be conducted hereon, until such time as a presiding officer shall be designated by the United States Office of Personnel Management and by the Secretary of the Board of Governors as provided herein.

11. MCorp is hereby directed to file an answer to this Notice within 20 days of service of this Notice as provided by section 263.5(a) of the Rules of Practice for Hearings of the Board of Governors (12 CFR 263.5(a)). As provided in section 263.5(d) of the Rules of Practice for Hearings of the Board of Gorvernors (12 CFR 263.5 (d)), the failure of MCorp to file an answer required by this Notice within the time provided herein shall constitute a waiver of MCorp's right to appear and contest the allegations of this Notice and authorization for the presiding officer, without further notice to MCorp, to find the facts to be as alleged in the Notice and to file with the Secretary of the Board of Governors a recommended decision containing such findings and appropriate conclusions.

Dated at Washington, D.C., this 19th day of October, 1988.

BOARD OF GOVERNORS OF THE
FEDERAL RESERVE SYSTEM

By: /s/ William W. Wiles
WILLIAM W. WILES
Secretary of the Board

UNITED STATES OF AMERICA
BEFORE THE BOARD OF GOVERNORS
OF THE FEDERAL RESERVE SYSTEM
WASHINGTON, D.C.

No. 88-062-C-HC

IN RE MCORP, DALLAS, TEXAS

[Filed: Oct. 19, 1988]

TEMPORARY ORDER TO CEASE AND DESIST

In consideration of the unsafe and unsound practices that MCorp, Dallas, Texas ("MCorp"), has engaged, is engaging and, unless restrained, will continue to engage in, and as such practices are otherwise specified in the Notice of Charges and of Hearing (the "Notice") attached hereto and made a part hereof, the Board of Governors of the Federal Reserve System (the "Board of Governors") has determined that the referenced unsafe and unsound practices of MCorp relating to (1) the deteriorating conditions of MCorp and its 26 subsidiary banks (referred to herein collectively as the "Subsidiary Banks"), and (2) MCorp's payment (and proposed payment) of cash dividends on its preferred stock at times when the bank holding company has suffered and is suffering large operating losses, has inadequate levels of capital protection on a consolidated basis and at its Subsidiary Banks, and significant volumes of problem, non-

performing assets at the Subsidiary Banks and likely to (a) cause the substantial dissipation of the assets of MCorp, (b) weaken seriously the condition of MCorp, or (c) seriously prejudice the interests of some of the Subsidiary Banks' depositors prior to the completion of the administrative proceedings ordered by the Board of Governors in the Notice.

The Board of Governors therefore hereby issues this Temporary Order to Cease and Desist (the "Temporary Order") and hereby orders, pursuant to section 8(c) of the Federal Deposit Insurance Act, as amended (12 U.S.C. 1818(c)), that:

1. MCorp shall not declare or pay any corporate dividends on its outstanding common or preferred stock without the prior written approval of the Federal Reserve Bank of Dallas and the Staff Director of the Division of Banking Supervision and Regulation of the Board of Governors.

2. All communications regarding this Temporary Order shall be sent to:

Mr. Robert D. Hankins
Vice President
Federal Reserve Bank of Dallas
Station K
Dallas, TX 75222

3. This Temporary Order shall become effective immediately upon service on MCorp and shall remain in full force and effect pending the completion or termination of the administrative proceedings initiated pursuant to the foregoing Notice, except to the extent that, and until such time as, any provision of this Temporary Order shall have been stayed, modified, suspended, or set aside by the Board of Governors or by a court in proceedings authorized by section 8(c)(2) of the Federal Deposit Insurance Act, as amended (12 U.S.C. 1818(c)(2)).

Dated at Washington, D.C., this 19th day of October, 1988.

BOARD OF GOVERNORS OF THE
FEDERAL RESERVE SYSTEM

By: /s/ William W. Wiles
WILLIAM W. WILES
Secretary of the Board

UNITED STATES OF AMERICA
BEFORE THE BOARD OF GOVERNORS
OF THE FEDERAL RESERVE SYSTEM
WASHINGTON, D.C.

No. 88-062-C-HC

IN RE MCORP, DALLAS, TEXAS

[Filed: Oct. 19, 1988]

TEMPORARY ORDER TO CEASE AND DESIST

In consideration of the unsafe and unsound practices that MCorp, Dallas, Texas ("MCorp"), has engaged, is engaging and, unless restrained, will continue to engage in, and as such practices are otherwise specified in the Notice of Charges and of Hearing (the "Notice") attached hereto and made a part hereof, the Board of Governors of the Federal Reserve System (the "Board of Governors") has determined that the referenced unsafe and unsound practices of MCorp relating to (1) the deteriorating conditions of MCorp and its 26 subsidiary banks (referred to herein collectively as the "Subsidiary Banks"), and (2) the extremely poor condition of the MCorp Organization, the large operating losses suffered by MCorp, the inadequate levels of capital protection on a consolidated basis and at MCorp's Subsidiary Banks, and the significant volume of problem, nonperforming assets at the Subsidiary Banks are likely to (a) cause

the substantial dissipation of the assets of MCorp, (b) cause the insolvency of MCorp or some of the Subsidiary Banks, (c) weaken seriously the condition of MCorp or some of the Subsidiary Banks, or (d) seriously prejudice the interests of some of the Subsidiary Banks' depositors prior to the completion of the administrative proceedings ordered by the Board of Governors in the Notice.

The Board of Governors therefore hereby issues this Temporary Order to Cease and Desist (the "Temporary Order") and hereby orders, pursuant to section 8(c) of the Federal Deposit Insurance Act, as amended (12 U.S.C. 1818(c)) and section 5(b) of the Bank Holding Company Act of 1956, as amended (12 U.S.C. 1844(c)), that:

1. (a) From the effective date of this Temporary Order, MCorp shall not, directly or indirectly, enter into, participate, or in other manner, engage in any transaction that would, in any manner, have the effect of dissipating, or result in the dissipation of, the assets described in paragraph 5 of the Notice attached hereto ("Holding Company Assets") without the prior written approval of the Federal Reserve Bank of Dallas (the "Reserve Bank").

(b) Any request for prior approval pursuant to this paragraph shall be accompanied by documentation adequate to provide the Reserve Bank with the details of each proposed transaction, including a full description of the proposal, the purpose(s) for the transaction, the amounts involved, the benefits to be derived by MCorp and any of its Subsidiary Banks, and such other matters that may be pertinent to the transaction and assist the Reserve Bank in its review of each proposal.

(c) Notwithstanding the requirements of paragraph 1(a) hereof, MCorp may enter into, participate, or in any other manner, engage in any transaction that would have the effect of dissipating, or result in the dissipation of, Holding Company Assets without the prior written

approval of the Reserve Bank if such a transaction involves or relates to: (1) interest payments or principal reductions on any outstanding debt that MCorp is obligated to make pursuant to contractual obligations in effect as of the effective date of this Temporary Order, (2) salaries, but not bonuses, or (3) payments for goods and services, including salaries, being provided to meet the legitimate needs of MCorp that MCorp is obligated to make pursuant to contractual obligations in effect as of the effective date of this Temporary Order.

2. All communications regarding this Temporary Order shall be sent to:

Mr. Robert D. Hankins
Vice President
Federal Reserve Bank of Dallas
Station K
Dallas, TX 75222

3. This Temporary Order shall become effective immediately upon service on MCorp and shall remain in full force and effect pending the completion or termination of the administrative proceedings initiated pursuant to the foregoing Notice, except to the extent that, and until such time as, any provision of this Temporary Order shall have been stayed, modified, suspended, or set aside by the Board of Governors or by a court in proceedings authorized by section 8(c)(2) of the Federal Deposit Insurance Act, as amended (12 U.S.C. 1818 (c)(2)).

Dated at Washington, D.C., this 19th day of October, 1988.

BOARD OF GOVERNORS OF THE
FEDERAL RESERVE SYSTEM

By: /s/ William W. Wiles
WILLIAM W. WILES
Secretary of the Board

UNITED STATES OF AMERICA
BEFORE THE BOARD OF GOVERNORS
OF THE FEDERAL RESERVE SYSTEM
WASHINGTON, D.C.

No. 88-062-B-HC

IN RE MCORP, DALLAS, TEXAS

[Filed: Oct. 26, 1988]

AMENDED NOTICE OF CHARGES AND OF HEARING ISSUED PURSUANT TO THE FEDERAL DEPOSIT INSURANCE ACT, AS AMENDED, AND THE BANK HOLDING COMPANY ACT OF 1956, AS AMENDED

The Board of Governors of the Federal Reserve System (the "Board of Governors") has reasonable cause to believe that MCorp, Dallas, Texas ("MCorp"), a registered bank holding company, has engaged, is engaging and, unless restrained, will continue to engage in unsafe and unsound practices and violations of law and regulation in conducting the business of MCorp, and that, as a result of the unsafe and unsound practices and violations, the financial condition of MCorp and its subsidiary banks are likely to be adversely affected.

Accordingly, the Board of Governors hereby institutes this proceeding for the purpose of determining whether an appropriate order to cease and desist should be issued against MCorp and issues this amended Notice of Charges

and of Hearing (the "Amended Notice"), which amends the Notice of Charges and of Hearing issued against MCorp on October 19, 1988, in implementation thereof pursuant to the provisions of sections 8(b)(1) and 8(b)(3) of the Federal Deposit Insurance Act, as amended (the "Act"), (12 U.S.C. 1818(b)(1) and (3)), section 5(b) of the Bank Holding Company Act of 1956, as amended (the "BHC Act") (12 U.S.C. 1844(b)) and the Board of Governors' Rules of Practice for Hearings (12 CFR Part 263).

In support of this Amended Notice, the Board of Governors alleges the following:

1. MCorp, a corporation existing and doing business under the laws of the States of Delaware and Texas, is and has been at all times pertinent to the charges herein a registered bank holding company. MCorp, therefore, is and has been at all times pertinent to the charges herein subject to the Act (12 U.S.C. 1818 *et seq.*), the BHC Act (12 U.S.C. 1841 *et seq.*) and the rules and regulations of the Board of Governors (12 CFR 201 *et seq.*).

2. As of the date of this Amended Notice, MCorp owns 26 subsidiary banks and 17 active nonbank subsidiaries (referred to herein collectively as the "Subsidiary Banks" and the "Nonbank Subsidiaries", respectively), and, by virtue of such ownership, controls the affairs and management of the Subsidiary Banks and the Nonbank Subsidiaries.

3. The conditions of MCorp and its Subsidiary Banks and Nonbank Subsidiaries have been deteriorating, and the MCorp organization is currently in extremely poor condition, with a large volume of nonperforming assets, inadequate levels of capital protection, operating losses and insufficient reserves for the kind and quality of its problem assets. In particular:

(a) For the year ending December 31, 1985, MCorp reported that, on a consolidated basis, nonperforming assets were $534 million or 3.5 percent of the organization's total loans and other nonperforming assets. For the year ending December 31, 1986, consolidated nonperforming assets had risen to $1.2 billion or 7.6 percent of MCorp's total loans and other nonperforming assets. For the year ending December 31, 1987, nonperfoming assets on a consolidated basis stood at $1.6 billion or 11.5 percent of the organization's total loans and other nonperforming assets. By the end of the third quarter of 1988, as of September 30, 1988, consolidated nonperforming assets had increased to $2.0 billion or 15.7 percent of total consolidated loans and other nonperforming assets.

(b)(1) For the year ending December 31, 1985, MCorp's consolidated equity capital stood at 5.7 percent of the organization's consolidated total assets. For the year ending December 31, 1986, the company's consolidated equity capital was 5.2 percent of its consolidated total assets. For the year ending December 31, 1987, MCorp's consolidated equity capital had decreased to 4.2 percent of its consolidated total assets. As of the second quarter of 1988, ending June 30, 1988, the organization's equity capital had declined further to 4.1 percent of its total assets.

(2) As of September 30, 1988, MCorp's consolidated equity capital deteriorated further and stood at approximately 1.7 percent of the organization's consolidated total assets, and its consolidated equity capital, excluding intangible assets, stood at 0.3 percent of its total tangible assets.

(c) For the year ending December 31, 1985, MCorp reported, on a consolidated basis, net income of $132 million. For the year ending December 31, 1986, MCorp reported, on a consolidated basis, net losses of $82 million. For the year ending December 31, 1987, MCorp reported, on a consolidated basis, net losses of $258 million. For the first half of 1988, ending June 30, 1988, MCorp had a one-time, extraordinary gain in excess of

$200 million on the sale of the controlling interest of a nonbank subsidiary, but, because of significant operating losses, reported consolidated net losses of $12 million. In the third quarter of 1988, MCorp suffered consolidated losses of $517 million, thereby reporting year-to-date net consolidated losses of $529 million as of September 30, 1988.

(d) As of December 31, 1986, MCorp reported, on a consolidated basis, that the organization's allowance for possible losses on loans and foreclosed property was 39.1 percent of the organization's nonperforming assets. As of December 31, 1986, the reserves for loan losses of the 50 largest bank holding companies in the United States, which included MCorp, averaged 63 percent of nonperforming assets, on a weighted basis. As of December 31, 1987, MCorp reported, on a consolidated basis, that the organization's allowance for possible losses on loans and foreclosed property was 26.3 percent of the organization's nonperforming assets. As of December 31, 1987, the reserves for loan losses of the 50 largest bank holding companies in the United States, including MCorp, averaged 80 percent of nonperforming assets, on a weighted basis. As of September 30, 1988, MCorp reported, on a consolidated basis, that the organization's allowance for possible losses on loans and foreclosed property was 36.9 percent of the organization's nonperforming assets. As of June 30, 1988, the reserves for loan losses of the 50 largest bank holding companies in the United States, including MCorp, averaged about 91 percent of nonperforming assets, on a weighted basis.

(e) On November 4, 1986, MCorp entered into a Memorandum of Understanding (the "MOU") with the Federal Reserve Bank of Dallas, which provided, *inter alia*, that "MCorp will take all necessary steps to ensure that adequate capital positions are maintained at the holding company and at each of its subsidiary banks and nonbank subsidiaries".

(f) On October 7, 1988, MCorp requested that the Federal Deposit Insurance Corporation provide MCorp

with federal financial assistance, pursuant to section 13(c) of the Act (12 U.S.C. 1823(c)); and the Federal Deposit Insurance Corporation has subsequently informed MCorp that, as a condition to proceeding with such assistance, MCorp should immediately use its available assets to support the Subsidiary Banks.

(g) On October 24, 1988, MCorp announced that (1) the board of directors of MCorp declared a moratorium on the payment of principal and interest on all parent company public and privately placed indebtedness for borrowed money, (2) the debt moratorium will remain in place until further notice, (3) the moratorium permits MCorp to marshall its assets in connection with its recapitalization proposal, and (4) the resources retained through the moratorium, coupled with the other assets of the company, are intended to be used in connection with the recapitalization of the company and its banking subsidiaries.

4. As a result of the conditions described in paragraph 3 hereof, *i.e.*, the extraordinary high volume of poor quality and nonperforming assets, the conditions of the Subsidiary Banks have deteriorated to critical levels. In particular:

(a) The Minimum Capital Ratios Regulation of the Office of the Comptroller of the Currency (the "OCC") (12 CFR Part 3) provides that the minimally acceptable ratio of primary capital to total assets for national banking institutions in the soundest and strongest financial conditions is 5.5 percent. The OCC's capital regulation further provides that national banks in unsatisfactory conditions, such as the majority of the 26 Subsidiary Banks that are nationally chartered, are expected to hold additional capital adequate to compensate for their higher levels of risks. The Subsidiary Banks that are national banks, in accordance with the OCC's regulation, are required to maintain capital in excess of the minimally acceptable ratio of 5.5 percent of total assets.

(b) As of September 30, 1988, 22 of the Subsidiary Banks had primary capital ratios below 5.5 percent of their total assets.

(c) In order to increase the capital accounts of the Subsidiary Banks that have primary capital ratios below 5.5 percent to applicable regulatory capital requirements, the banks would need capital injections of between $420 and $430 million.

(d) The Board of Governors has reasonable cause to believe that, based on the volume of classified assets at the Subsidiary Banks, their earnings and other related factors, some of the Subsidiary Banks are in danger of failing in the absence of increases in their capital accounts.

(e) On or about October 27, 1988, the Office of the Comptroller of the Currency (the "OCC") (1) will issue notices of its intent to issue capital directives, pursuant to the International Lending Supervision Act of 1983 (12 U.S.C. 3907 *et seq.*), to 18 of the nationally chartered Subsidiary Banks, (2) will require these banks to attain primary capital ratios of 4.5 percent, and (3) will provide these banks with a period of two days to respond to the OCC's notices.

5. (a) As of September 30, 1988, the MCorp parent group, which excludes the Subsidiary Banks, had total assets in excess of $400 million. As of the date of this Amended Notice, a significant portion of these assets are available to be used to fund direct capital contributions to those Subsidiary Banks experiencing capital deficiencies.

(b) As of the date of this Amended Notice, the available assets of MCorp described in paragraph 5(a) hereof are sufficient to increase the capital accounts of those Subsidiary Banks with inadequate capital to minimum levels.

6. Given MCorp's past failure to support adequately its Subsidiary Banks, its failure to comply with the capital provision of the MOU, and representations by MCorp management to the staff of the Board of Governors, the Board of Governors has reasonable cause to believe that

MCorp will not use any of its available assets to make direct capital contributions to the Subsidiary Banks that have levels of capital protection below the standards set by the Subsidiary Banks' primary federal regulator.

7. MCorp and its management have engaged, are engaging, and, unless restrained, will continue to engage in unsafe and unsound practices and violations of law and regulation that have weakened and will continue to weaken seriously the condition of MCorp and the Subsidiary Banks' depositors, and are likely to cause substantial dissipation of the assets of MCorp that could be used to allow MCorp to serve as a source of financial strength for the Subsidiary Banks. In particular:

(a) (1) Section 5(b) of the BHC Act (12 U.S.C. 1844(b) provides that:

> The Board is authorized to issue such regulations and orders as may be necessary to enable it to administer and carry out the purpose of this chapter (the BHC Act) and prevent evasions thereof.

(2) Section 225.4(a)(1) of Regulation Y of the Board of Governors (12 CFR 225.4(a)(1)) provides that:

> A bank holding company shall serve as a source of financial and managerial strength to its subsidiary banks and shall not conduct its operations in an unsafe or unsound manner.

(3) Under the provisions of law and regulation set forth in paragraphs 7(a)(1) and (2) hereof, a bank holding company, in accordance with Board of Governors' Policy Statement on the responsibility of bank holding companies to act as sources of strength to their subsidiary banks, should use its available resources to provide adequate capital funds to its subsidiary banks, particularly in the event that such assistance is necessary to prevent the deterioration or the failure of any of its subsidiary banks.

(4) As described in paragraph 5 hereof, the MCorp parent group has available assets that could be used where appropriate to fund direct capital contributions to those Subsidiary Banks that do not meet applicable regulatory capital requirements.

(5) By letter dated August 24, 1988, a shareholder and creditor of MCorp advised MCorp that, in its view, MCorp has a duty to preserve sufficient liquid assets and other assets to enable MCorp to pay its debts and dividends on its outstanding preferred stock and that MCorp should not make what the shareholder and creditor believed to be unrecoverable investments in its Subsidiary Banks.

(6) The Board of Governors has reasonable cause to believe that, unless restrained, MCorp and its management in response to pressure from shareholders and creditors will fail to maintain current assets at the parent company level that could be used, where appropriate, to provide adequate capital to the Subsidiary Banks in order to prevent the deterioration of such banks and thereby will engage in an unsafe and unsound banking practice and a violation of section 225.4(a)(1) of Regulation Y of the Board of Governors and that would limit MCorp's ability to serve as source of financial strength to the Subsidiary Banks.

(7) As a result of the conditions and practices described in paragraphs 3, 4, 5, and 6 hereof, most of the Subsidiary Banks are in critical financial condition, and they will continue to deteriorate unless MCorp makes immediate capital injections in accordance with the requirements of the Subsidiary Banks' primary federal regulator.

(8) By failing to use available assets to make needed capital injections into Subsidiary Banks with capital deficiences as the financial conditions of such banks have deteriorated, MCorp and its management improperly limited the company's ability to enhance the Subsidiary Banks' capital and, thereby, threatened the continued financial viability of the Subsidiary Banks. Thus, MCorp and its management have engaged in an unsafe and unsound practice, a violation of section 225.4(a)(1) of Regulation Y of the Board of Governors, and a violation of the capital provision of the MOU that adversely affected MCorp's condition and the conditions of the Subsidiary Banks and that limited MCorp's ability to serve as a source of financial strength to the Subsidiary Banks. In particular, as set forth in paragraph 5 hereof, MCorp had funds available to inject needed capital into the Subsidary Banks and, as of the date of this Amended Notice, McCorp, as the Subsidiary Banks' parent holding company and sole shareholder, has failed to inject the adequate capital funds into the Subsidiary Banks to prevent their deterioration.

(9) The Board of Governors has reasonable cause to believe that, unless restrained, MCorp and its management will fail to use its available resources to provide adequate capital to the Subsidiary Banks in order to prevent the continued deterioration of such banks and thereby will engage in an unsafe and unsound banking practice, a violation of section 225.4(a)(1) of Regulation Y of the Board of Governors, and a violation of the MOU that would adversely affect MCorp's condition and the conditions of the Subsidiary Banks and that would limit MCorp's ability to serve as source of financial strength to the Subsidiary Banks. In particular, the Board of Governors has reasonable cause to believe that the financial condition of the MCorp organization will continue to deteriorate and that MCorp will not take such actions as are necessary to recapitalize one or more of the Subsidiary Banks after it is determined by the banks' primary federal regulator that the Subsidiary Banks' capital accounts are deficient.

(b) MCorp and its management have engaged in unsafe and unsound dividend practices by using funds to pay cash dividends at a time when the severe financial condition of the Subsidiary Banks warranted capital in-

jections. In particular, for the year ending December 31, 1986, MCorp paid cash dividends on its common stock and preferred stock of approximately $45 million and $11 million, respectively. For the year ending December 31, 1987, MCorp paid cash dividends on its preferred stock of approximately $14 million. During the first three quarters of 1988, ending September 30, 1988, MCorp has paid cash dividends on its preferred stock of approximately $12 million. A cash dividend on MCorp's preferred stock in the amount of $840,000 was paid on October 14, 1988, and additional cash dividends on preferred stock in the approximate amount of $2.0 million were to be paid by MCorp on October 25 and November 1, 1988 but were halted by the issuance of a temporary cease and desist order by the Board of Governors. These cash dividends were paid to shareholders in years when MCorp reported operating losses, as described in paragraph 3(c) hereof, in contravention of the Board of Governors' Policy Statement on the payment of cash dividends by bank holding companies, issued November 14, 1985 (F.R.R.S. 4-877). Moreover, these cash dividends were paid out to shareholders in years when, as described in paragraphs 3(b), 4 and 6 hereof, the capital of the Subsidiary Banks and MCorp deteriorated below minimally accepted levels and MCorp failed to inject adequate amounts of new capital into the Subsidiary Banks.

8. (a) MCorp and its management have failed to operate MCorp, the Subsidiary Banks and the Nonbank Subsidiaries in a safe, sound and lawful manner as set forth in paragraphs 3, 4, 6, and 7 hereof.

(b) MCorp and its management have engaged, are engaging and, unless restrained, will continue to engage in the unsafe and unsound practices and violations of law and regulation set forth in paragraphs 3, 4, 6, and 7 hereof. In particular, the Board of Governors has reasonable cause to believe that MCorp will not take the actions that are necessary (1) to prevent the substantial dissipation of corporate assets through cash dividends, (2) to

use all available resources to make immediate capital injections into the Subsidiary Banks described in paragraph 4 hereof, and (3) to maintain and prevent the dissipation of available resources at the parent company level that could be used, where appropriate, to make immediate capital injections into the Subsidiary Banks.

9. Notice is hereby given that a hearing will be held on December 12, 1988 at the Federal Reserve Bank of Dallas for the purpose of taking evidence on the charges hereinbefore specified in order to determine whether an appropriate order should be issued under the Act and the BHC Act requiring MCorp to cease and desist from the unsafe or unsound practices herein specified or to take affirmative action to correct the conditions resulting from such unsafe or unsound practices. Appropriate corrective action may include the issuance of a cease and desist order:

(a) Prohibiting the payment of all cash dividends;

(b) prohibiting the dissipation of parent group assets that could be used to fund capital injections into the Subsidiary Banks, except for the payment of debts in accordance with contractual obligations, corporate salaries and operating expenses;

(c) requiring compliance with the capital provision of the MOU;

(d) requiring the implementation of an acceptable capital plan that would ensure that all of MCorp's available assets are used to recapitalize the Subsidiary Banks that are suffering capital deficiencies;

(e) taking all necessary actions to ensure compliance with any orders or capital directives issued by the OCC relating to the capital needs of the Subsidiary Banks and reporting to the Board of Governors concerning which Subsidiary Banks will receive capital injections from MCorp; and

(f) such other affirmative actions as may be appropriate under the circumstances of this matter.

10. The hearing referred to in paragraph 9 hereof shall be held before an administrative law judge to be appointed by the United States Office of Personnel Management pursuant to section 3344 of Title 5 of the United States Code (5 U.S.C. 3344). The hearing shall be private, unless the Board of Governors shall determine that a public hearing is necessary to protect the public interests, and in all other aspects shall be conducted in compliance with the provision of the Act and the Board of Governors' Rules of Practice for Hearings.

11. Authority is hereby delegated to the Secretary of the Board of Governors to designate the time and place and presiding officer for any hearing that may be conducted on this Amended Notice and take any and all actions that the presiding officer would be authorized to take under the Board of Governors' Rules of Practice for Hearings with respect to this Amended Notice and any hearing to be conducted hereon, until such time as a presiding officer shall be designated by the United States Office of Personnel Management and by the Secretary of the Board of Governors as provided herein.

12. MCorp is hereby directed to file an answer to this Amended Notice within 20 days of service of this Amended Notice as provided by section 263.5(a) of the Rules of Practice for Hearings of the Board of Governors (12 CFR 263.5(a)). As provided in section 263.5(d) of the Rules of Practice for Hearings of the Board of Governors (12 CFR 263.5(d)), the failure of MCorp to file an answer required by this Amended Notice within the time provided herein shall constitute a waiver of MCorp's right to appear and contest the allegations of this Amended Notice and authorization for the presiding officer, without further notice to MCorp, to find the facts to be as alleged in this Amended Notice and to file with the Secretary of the Board of Governors a recommended decision containing such findings and appropriate conclusions.

Dated at Washington, D.C., this 26th day of October, 1988.

BOARD OF GOVERNORS OF THE
FEDERAL RESERVE SYSTEM

By: /s/ William W. Wiles
WILLIAM W. WILES
Secretary of the Board

UNITED STATES OF AMERICA
BEFORE THE BOARD OF GOVERNORS
OF THE FEDERAL RESERVE SYSTEM
WASHINGTON, D.C.

No. 88-062-C-HC

IN RE MCORP, DALLAS, TEXAS

[Filed: Oct. 26, 1988]

TEMPORARY ORDER TO CEASE AND DESIST

In consideration of the unsafe and unsound practices and violation of law and regulation that MCorp, Dallas, Texas ("MCorp"), has engaged, is engaging and, unless restrained, will continue to engage in, and as such practices and violation are otherwise specified in the Amended Notice of Charges and of Hearing (the "Amended Notice") attached hereto and made a part hereof, the Board of Governors of the Federal Reserve System (the "Board of Governors") has determined that the referenced unsafe and unsound practices and violation of MCorp relating to (1) the deteriorating conditions of MCorp and its subsidiary banks (referred to herein collectively as the "Subsidiary Banks"), (2) the possible failure of some of the Subsidiary Banks in the absence of prompt capital assistance, and (3) MCorp's failure to comply with the capital provision of the Memorandum of Understanding, dated November 4, 1988, between MCorp and the Federal Reserve Bank of Dallas and its failure to

serve as a source of financial strength to the Subsidiary Banks by failing to inject its available assets as capital into those Subsidiary Banks that are experiencing capital deficiencies and asset quality problems are likely to (a) weaken seriously the condition of those Subsidiary Banks with inadequate levels of capital protection, or (b) seriously prejudice the interests of such Subsidiary Banks' depositors prior to the completion of the administrative proceedings ordered by the Board of Governors in the Amended Notice.

The Board of Governors therefore hereby issues this Temporary Order to Cease and Desist (the "Temporary Order") and hereby orders, pursuant to section 8(a) of the Federal Deposit Insurance Act, as amended (12 U.S.C. 1818(c)) and section 5(b) of the Bank Holding Company Act of 1965, an amended (12 U.S.C. 1844(c)), that:

1. MCorp shall (a) take such actions as are necessary to use all of its assets to provide capital support to its Subsidiary Banks in need of additional capital, and (b) within 15 days of the effective date of this Temporary Order, report to the Board of Governors on the identity of those Subsidiary Banks into which capital injections will be made by MCorp and the amount of capital to be injected into each such bank. In reviewing MCorp's proposed capital injections, the Board of Governors shall take into account any orders or capital directives issued with respect to the Subsidiary Banks by their primary bank regulator. The Board of Governors may issue such further temporary orders to cease and desist as may be necessary to implement this Temporary Order.

2. All communications regarding this Temporary Order shall be sent to:

Mr. Robert D. Hankins
Vice President
Federal Reserve Bank of Dallas
Station K
Dallas, TX 75222

3. This Temporary Order shall become effective immediately upon service on MCorp and shall remain in full force and effect pending the completion or termination of the administrative proceedings initiated pursuant to the foregoing Amended Notice, except to the extent that, and until such time as, any provision of its Temporary Order shall have been stayed, modified, suspended, or set aside by the Board of Governors or by a court in proceedings authorized by section 8(c)(2) of the Federal Deposit Insurance Act, as amended (12 U.S.C. 1818(c)(2)).

Dated at Washington, D.C. this 26th day of October, 1988.

BOARD OF GOVERNORS OF THE
FEDERAL RESERVE SYSTEM

By: /s/ William W. Wiles
WILLIAM W. WILES
Secretary of the Board

UNITED STATES OF AMERICA
BEFORE THE BOARD OF GOVERNORS
OF THE FEDERAL RESERVE SYSTEM
WASHINGTON, D.C.

No. 88-062-B2-HC

IN RE MCORP, DALLAS, TEXAS

and

MCORP MANAGEMENT, DALLAS, TEXAS

[Filed: Mar. 30, 1989]

NOTICE OF CHARGES AND OF HEARING ISSUED PURSUANT TO THE FEDERAL DEPOSIT INSURANCE ACT, AS AMENDED, AND THE BANK HOLDING COMPANY ACT OF 1956, AS AMENDED

The Board of Governors of the Federal Reserve System (the "Board of Governors") has reasonable cause to believe that MCorp, Dallas, Texas ("MCorp"), a registered bank holding company, and MCorp Management, Dallas, Texas ("MCorp Management"), a nonbank subsidiary of MCorp, have engaged, are engaging and, unless restrained, will continue to engage in unsafe and unsound practices and violations of law in conducting the business of MCorp and MCorp Management, and that, as a result of the violations, the financial condition of

MCorp and its subsidiary banks are likely to be adversely affected.

Accordingly, the Board of Governors hereby institutes this proceeding for the purpose of determining whether an appropriate order to cease and desist should be issued against MCorp or MCorp Management and issues this Notice of Charges and of Hearing (the "Notice"), in implementation thereof pursuant to the provisions of sections 8(b)(1) and 8(b)(3) of the Federal Deposit Insurance Act, as amended (the "Act") (12 U.S.C. 1818 (b)(1) and (3)), section 5(b) of the Bank Holding Company Act of 1956, as amended (the "BHC Act") (12 U.S.C. 1844)) and the Board of Governors' Rules of Practice for Hearings (12 CFR Part 263).

In support of this Notice, the Board of Governors alleges the following:

1. MCorp, a corporation existing and doing business under the laws of the States of Delaware and Texas, is and has been at all times pertinent to the charges herein a registered bank holding company. MCorp, therefore, is and has been at all times pertinent to the charges herein subject to the Act (12 U.S.C. 1818 *et seq.*), the BHC Act (12 U.S.C. 1841 *et seq.*) and the rules and regulations of the Board of Governors (12 CFR 201 *et seq.*).

2. MCorp Management, a corporation existing and doing business under the laws of the State of Texas, is and has been at all times pertinent to the charges herein a nonbank subsidiary of MCorp. MCorp Management, therefore, is and has been at all times pertinent to the charges herein subject to the Act, the BHC Act and the rules and regulations of the Board of Governors.

3. Until March 29, 1989, MCorp owned 25 subsidiary banks and, as of the date of this Notice, 17 active nonbank subsidiaries (referred to herein collectively as the "Subsidiary Banks" and the "Nonbank Subsidiaries", respectively), and, by virtue of such ownership, controlled

the affairs and management of the Subsidiary Banks and the Nonbank Subsidiaries. As of the date of this Notice, MCorp continues to own 5 Subsidiary Banks.

4. Section 23A of the Federal Reserve Act ("Section 23A") (12 U.S.C. 371c) provides, *inter alia*, that member banks, such as the Subsidiary Banks, may not extend credit to an affiliate unless at the time of the transaction the extension of credit is fully secured by collateral having a market value of at least 100 percent of the amount of the extension of credit.

5. (a) MCorp and its management and MCorp Management and its management have violated Section 23A by causing two of the Subsidiary Banks—MBank Preston, Texas ("MBank Preston") and MBank Houston, Houston, Texas ("MBank Houston)—to extend credit of approximately $63.7 million to an affiliate, MCorp Management, on an unsecured basis in violation of Section 23A. In particular:

(1) In 1985, MCorp established a Delaware credit card bank, MBank USA, which was a subsidiary of one of MCorp's Nonbank Subsidiaries, MNet, Dallas, Texas ("MNet"). MBank USA was funded, in part, by the advancement of federal funds from MBank Preston and MBank Houston. As part of this transaction, MBank USA agreed to pay MBank Preston and MBank Houston a percentage of the income earned on its credit card operations up to a fixed dollar amount of approximately $79.9 million over an eight year period.

(2) In 1986, MCorp sold MNet, and with it MBank USA, to Lomas & Nettleton Financial Corporation, Dallas, Texas ("L&N"). At that time, MBank Preston and MBank Houston released MBank USA from all of its obligations to them. At the same time, MCorp Managment, a wholly owned Nonbank Subsidiary of MCorp and an affiliate of the Subsidiary Banks, agreed that it would pay MBank Preston and MBank Houston on a quarterly basis, up to a fixed dollar amount, a percentage of the income amount earned by the MCorp organi-

zation from the preferred stock and debentures received from L&N as partial consideration for MBank USA. In particular, MCorp Management agreed to pay MBank Preston and MBank Houston up to approximately $63.7 million over a seven year period.

(b) (1) The agreement in 1986 of MCorp Management to pay MBank Preston and MBank Houston up to approximately $63.7 million over a seven year period represents extensions of credit by these two Subsidiary Banks to an affiliate. MCorp Management's obligations to pay MBank Preston and MBank Houston were unsecured extensions of credit that violated the provisions of Sections 23A at the time the extensions were made.

(2) Since 1986, MCorp Management has paid approximately $8.4 million on its unsecured extensions of credit from its affiliates, MBank Preston and MBank Houston. These payments reflect the maximum amounts owed to MBank Preston through March 31, 1987 and to MBank Houston through December 31, 1987 under the 1986 payment agreements. MBank Preston subsequently was merged in to [*sic*] MBank Dallas, Dallas, Texas ("MBank Dallas"), which succeeded to MBank Preston's rights under the agreement with MCorp Management. As of the date of this Notice, MCorp Management is past due on its unsecured extension of credit from MBank Dallas by as much as $7.9 million and is past due on its unsecured extension of credit from MBank Houston by as much as $6.9 million. As of the date of this Notice, the Board of Governors has reasonable cause to believe that MCorp Management has failed to repay these extensions of credit on a timely basis despite L&N's timely dividends and debt payments to the MCorp organization on the L&N preferred stock and debentures held by the MCorp organization.

6. As of the date of this Notice, MCorp and its management and MCorp Management and its management have engaged, are engaging and, unless restrained, will continue to engage in unsafe and unsound practices in

that (a) MCorp and MCorp Management have failed to cause MBank Dallas and MBank Houston to record or report properly on their books and financial statements the amounts due from MCorp Management on the unsecured extensions of credit described in paragraph 4 hereof, (b) MCorp Management has not properly recorded or reported on its books and financial statements the unsecured extensions of credit from these two Subsidiary Banks, and (c) MCorp Management had failed to account properly for the arrearages totalling over $14 million that are due to MBank Dallas and MBank Houston and has failed to record or report such arrearages on its books and financial statements.

7. (a) MCorp and its management and MCorp Management and its management have failed to operate MCorp, the Subsidiary Banks and the Nonbank Subsidiaries in a lawful and safe and sound manner as set forth in paragraphs 5 and 6 hereof.

(b) MCorp and its management and MCorp Management and its management have engaged, are engaging and, unless restrained, will continue to engage in the practices and violations of law set forth in paragraphs 5 and 6 hereof. In particular, the Board of Governors has reasonable cause to believe that, prior to the insolvency of some of the Subsidiary Banks on March 28, 1989, MCorp and MCorp Management did not take the actions that were necessary to correct the violations of Section 23A of the Federal Reserve Act and to record and report properly the transactions described in this Notice.

8. As of the date of this Notice, the Board of Governors has reasonable cause to believe that a petition to place MCorp into involuntary bankruptcy has been filed by several of its creditors and that MCorp has stated that it intends to convert the involuntary bankruptcy into a voluntary reorganization under the provisions of Chapter 11 of the Federal Bankruptcy Code. The Board of Governors is of the opinion that the commencement and continuation of the proceedings against MCorp or MCorp

Management instituted by this Notice would be exempt from the automatic stay provisions of the Federal Bankruptcy Code.

9. Notice is hereby given that a hearing will be held on May 29, 1989 at the Federal Reserve Bank of Dallas for the purpose of taking evidence on the charges hereinbefore specified in order to determine whether an appropriate order should be issued under the Act and the BHC Act requiring MCorp and MCorp Management to cease and desist from the practices and violations of law herein specified or to take such affirmative action as may be appropriate under the circumstances of this matter.

10. The hearing referred to in paragraph 9 hereof shall be held before an administrative law judge to be appointed by the United States Office of Personnel Management pursuant to section 3344 of Title 5 of the United States Code (5 U.S.C. 3344). The hearing shall be private, unless the Board of Governors shall determine that a public hearing is necessary to protect the public interests, and in all other aspects shall be conducted in compliance with the provision of the Act and the Board of Governors' Rules of Practice for Hearings.

11. Authority is hereby delegated to the Secretary of the Board of Governors to designate the time and place and presiding officer for any hearing that may be conducted on this Notice and take any and all actions that the presiding officer would be authorized to take under the Board of Governors' Rules of Practice for Hearings with respect to this Notice and any hearing to be conducted hereon, until such time as a presiding officer shall be designated by the United States Office of Personnel Management and by the Secretary of the Board of Governors as provided herein.

12. The provisions of this Notice do not supersede, modify, or, in any other manner, effect the provisions of the Amended Notice of Charges and of Hearing issued against MCorp by the Board of Governors on October 26, 1988.

13. MCorp and MCorp Management are hereby directed to file answers to this Notice within 20 days of service of this Notice as provided by section 263.5(a) of the Rules of Practice for Hearings of the Board of Governors (12 CFR 263.5(a)). As provided in section 263.5(d) of the Rules of Practice for Hearings of the Board of Governors (12 CFR 263.5(d)), the failure of MCorp or MCorp Management to file an answer required by this Notice within the time provided herein shall constitute a waiver, as the case may be, of MCorp's of MCorp Management's right to appear and contest the allegations of this Notice and authorization for the presiding officer, without further notice to MCorp or MCorp Management, as the case may be, to find the facts to be as alleged in this Notice and to file with the Secretary of the Board of Governors a recommended decision containing such findings and appropriate conclusions.

Dated at Washington, D.C., this 30th day of March, 1989.

BOARD OF GOVERNORS OF THE
FEDERAL RESERVE SYSTEM

By: /s/ William W. Wiles
WILLIAM W. WILES
Secretary of the Board

UNITED STATES OF AMERICA
BEFORE THE BOARD OF GOVERNORS
OF THE FEDERAL RESERVE SYSTEM
WASHINGTON, D.C.

No. 88-062-B2-HC

IN RE MCORP, DALLAS, TEXAS

and

MCORP MANAGEMENT, DALLAS, TEXAS

[Filed: Apr. 19, 1989]

ANSWER OF MCORP AND MCORP MANAGEMENT TO NOTICE OF CHARGES AND OF HEARING

MCorp and McCorp Management, each a Debtor and Debtor-in-Possession in a Chapter 11 case under Title 11 of the United States Code, hereby answer the Notice of Charges and of Hearing (the "Notice") issued by the Board of Governors of the Federal Reserve System ("Board") on or about March 30, 1989, as follows:

STAY

1. On or about March 21, 1989, an involuntary petition under Chapter 7 of Title 11 of The United States Code (the "Bankruptcy Code") was filed against MCorp in the United States Bankruptcy Court for the Southern

District of New York. Pursuant to an Order of said Court dated March 31, 1989, MCorp converted said case to a case under Chapter 11 of the Bankruptcy Code. In addition, the MCorp Chapter 11 case was transferred to the United States Bankruptcy Court for the Southern District of Texas, Houston Division (the "Houston Court"), by Order of the United States Bankruptcy Court for the Southern District of New York dated April 4, 1989.

2. On March 31, 1989, MCorp Management filed a voluntary petition for relief under Chapter 11 of the Bankruptcy Code in the Houston Court. A Chapter 11 petition also was filed on that date and in that Court by MCorp Financial, Inc., a nonbank subsidiary of MCorp, and those cases are being jointly administered pursuant to an order of the Houston Court dated March 31, 1989. An Order for joint administration to consolidate the cases of MCorp, MCorp Management, and MCorp Financial, Inc. for administrative purposes has been sought.

3. Pursuant to 11 U.S.C. § 362(a), the filing of the Chapter 7 petition against MCorp on March 21, 1989, operated as a stay, applicable to all entities, of the commencement of any administrative proceeding against MCorp. Therefore, the filing and service of the Notice by the Board against MCorp on March 30, 1989, violated the automatic stay imposed by federal law. Accordingly, said Notice is void and a nullity as to MCorp. Moreover, the filing on March 31, 1989 of a voluntary petition for relief under Chapter 11 of the Bankruptcy Code by MCorp Management operated as an automatic stay of the continuation of any administrative proceeding against MCorp Management, including the one commenced by the Notice. Accordingly, this proceeding is now stayed as a matter of federal law.

4. MCorp and McCorp Management intend to file in the Houston Court an adversary proceeding against the Board, as Defendant, seeking injunctive relief against the Board, together with a motion for a temporary restrain-

ing order and a preliminary injunction against, *inter alia*, the continuation of this proceeding by the Board in violation of the automatic stay. MCorp and MCorp Management anticipate that said Court will grant said motion and enforce the stay, and respectfully request that the presiding officer of this proceeding similarly recognize the stay of the continuation of this proceeding forthwith.

5. Without waiver of said stay or their right to insist upon and enforce said stay, but expressly asserting and relying thereon, MCorp and MCorp Management nevertheless answer the Notice as follows.

DEFENSES

6. The charges made by the Board against MCorp and MCorp Management are without basis in law or in fact for each of the following reasons:

A. As of the date of the Notice and of this date, MBank Preston, N.A. ("MBank Preston") no longer existed and neither MBank Dallas, N.A. ("MBank Dallas") as successor by merger to MBank Preston, nor MBank Houston, N.A. ("MBank Houston") existed as a national banking association or was under the control of MCorp or MCorp Management because their respective charters had been revoked by the Comptroller of the Currency on or about March 28, 1989, when they were declared insolvent by the Comptroller of the Currency. Accordingly, neither MCorp nor MCorp Management are bank holding companies with respect to MBank Preston, MBank Dallas, or MBank Houston. It is not alleged, nor can it be alleged in good faith, that MCorp or MCorp Management is capable of causing either of said banks to take any action at this time, or that any circumstances similar to those which are the subject of this proceeding exist or have existed at any time with respect to any bank subsidiary now owned directly or indirectly by MCorp or MCorp

Management. Accordingly, and because the only proper purpose of this proceeding is remedial rather than compensatory or punitive, there are no grounds for issuance of any cease-and-desist order or order to take other affirmative action against MCorp or MCorp Management in this proceeding on the basis of the claims alleged in the Notice.

B. Section 23A of the Federal Reserve Act, 12 U.S.C. § 371c ("Section 23A"), is applicable to and restricts certain activities of member banks, and not of bank holding companies or nonbank subsidiaries of bank holding companies like MCorp and MCorp Management, respectively. Accordingly, MCorp and MCorp Management did not and could not violate Section 23A as alleged.

C. The Board is not the "appropriate Federal banking agency" within the meaning of 12 U.S.C. § 1813(g) to initiate and prosecute cease and desist proceedings with respect to violations of Section 23A allegedly committed by MBank Preston, MBank Dallas or MBank Houston, all of which were, prior to March 29, 1989, national banking associations subject to the primary jurisdiction of the Office of the Comptroller of the Currency. Therefore, pursuant to the express terms of 12 U.S.C. § 1818(b), the Board is without any jurisdiction or power whatsoever to conduct this proceeding.

D. The advancements of federal funds from MBank Preston and MBank Houston described in Section 5(a)(1) of the Notice were exempt from the collateralization requirements and quantitative limitations of Section 23A and none of the transactions described in Section 5(a)(2) of the Notice constituted an "extension of credit" or a "covered transaction" within the meaning of Section 23A, as alleged in Section 5(b)(1).

E. Prior to the date of the Notice, all amounts allegedly then owed or due and payable by MCorp

Management to MBank Dallas or MBank Houston had been released and/or satisfied by the course of dealing of the parties and by offset.

F. Neither MCorp nor MCorp Management are bank holding companies with respect to MBank Dallas, MBank Houston or MBank Preston. Therefore, the Board is without any jurisdiction or power whatsoever to conduct this proceeding.

G. The transactions at issue have been properly recorded and reported on MCorp Management's books, records and financial statements.

RESPONSES TO SPECIFIC ALLEGATIONS

7. MCorp and MCorp Management admit the allegations of Paragraph 1 of the Notice, except that they deny that MCorp is a bank holding company with respect to MBank Dallas, MBank Preston or MBank Houston, further deny that MCorp is subject to the Act, the BHC Act and the rules and regulations of the Board with respect to the charges contained in the Notice, and further deny that MCorp is incorporated under the laws of Texas. Defendants further assert that all of the assets of MCorp and MCorp Management are in *custodia legis* and are subject to the exclusive jurisdiction of the Houston Court, and are to be administered pursuant to the bankruptcy laws, which preempt, supersede and override all other laws, rules and regulations.

8. MCorp and MCorp Management admit the allegations of Paragraph 2 of the Notice, except to deny that MCorp Management is subject to the Act, the BHC Act and the rules and regulations of the Board with respect to the charges contained in the Notice, and that they assert that all of the assets of MCorp and MCorp Management are in *custodia legis* and are subject to the exclusive jurisdiction of the Houston Court, and are to be administered pursuant to the bankruptcy laws, which

preempt, supersede and override all other laws, rules and regulations.

9. MCorp and MCorp Management admit that, directly or indirectly through MCorp Financial, Inc., MCorp owned approximately 26 subsidiary banks immediately prior to March 28, 1989, and, as of the date of the Notice, it directly or indirectly owned approximately 17 nonbank subsidiaries; that, by virtue of such ownership, it had only such "control" of such subsidiaries as is appropriate and lawful for a bank holding company; and that as of the date of the Notice, MCorp continued to own, directly or indirectly, approximately 6 subsidiary banks; and MCorp and MCorp Management otherwise deny the allegations of Paragraph 3 of the Notice.

10. MCorp and MCorp Management admit the allegations of Paragraph 4 of the Notice as a general and partial summary of Section 23A.

11. MCorp and MCorp Management deny the allegations of Paragraph 5 of the Notice, except admit:

(A) that MBank U.S.A. ("MBank USA") was created in 1985 and was a credit card bank subsidiary of MNet Corp. ("MNet"), which was a nonbank indirect subsidiary of MCorp; that MBank Preston and MBank Houston sold federal funds to MBank USA; and that, in addition to agreeing to repay said federal funds with interest, MBank USA agreed to pay MBank Preston and MBank Houston certain additional Contingent Fees based upon the future net income of MBank USA, if any;

(B) that on or about December 30, 1986, the stock of MNet was sold to Lomas & Nettleton Financial Corporation ("L&N"); that on that date all outstanding federal funds advances were fully repaid to MBank Preston and MBank Houston with interest and MBank Preston and MBank Houston released MBank USA from all obligations, including the obligation to pay Contingent Fees to them, and

simultaneously therewith, in substitution of the aforementioned contingent fee arrangement involving MBank USA, MCorp Management agreed to pay MBank Preston and MBank Houston, on a quarterly basis through 1993, a percentage of the interest and dividends it might receive on certain notes and preferred stock of L&H, up to a combined maximum aggregate amount of approximately $63.7 million, which agreement did not constitute an "extension of credit;" and that no funds or other property of MBank Houston, MBank Dallas, or MBank Preston were ever received by MCorp Management in exchange or in consideration for such agreement;

(C) that MCorp Management made cash payments aggregating approximately $8.4 million to MBank Preston and MBank Houston pursuant to the aforementioned agreement; that these payments reflected the contingent payments due to MBank Preston through March 31, 1987 and to MBank Houston through December 31, 1987 under the December 30, 1986 agreements referred to in subsection (B) above; and that MBank Preston was subsequently merged into MBank Dallas.

12. MCorp and MCorp Management deny the allegations of Paragraph 6 of the Notice.

13. MCorp and MCorp Management deny the allegations of Paragraph 7 of the Notice.

14. MCorp and MCorp Management admit the allegations in the first sentence of Paragraph 8 of the Notice, deny that commencement or continuation of these proceedings is exempt from the automatic stay provision of 11 U.S.C. § 362, and are without knowledge as to the remaining allegations of Paragraph 8 of the Notice and therefore deny the same.

15. MCorp and MCorp Management assert that this proceeding is stayed and therefore deny the allegations of Paragraphs 9 through 13 of the Notice.

WHEREFORE, MCorp and MCorp Management respectfully request that this proceeding be stayed for all purposes and, without waiver of but subject to such request, pray that the charges set forth in the Notice be found to be without merit and dismissed; that no order to cease and desist or take other action be entered against MCorp or MCorp Management; and that MCorp and MCorp Management be granted such other relief to which they may be entitled.

UNITED STATES BANKRUPTCY COURT
SOUTHERN DISTRICT OF TEXAS
HOUSTON DIVISION

Jointly Admin. Chap. 11 Case Nos. 89-02312-H3-11,
89-02324-H5-11, and 89-02848-H2-11
Adversary Proc. No. 89-0298

IN RE: MCORP FINANCIAL, INC., ETC.,
MCORP MANAGEMENT, AND MCORP, ETC., DEBTORS.
MCORP, MCORP FINANCIAL, INC., AND
MCORP MANAGEMENT, DEBTORS IN POSSESSION,
PLAINTIFFS

v.

THE BOARD OF GOVERNORS OF THE FEDERAL RESERVE
SYSTEM OF THE UNITED STATES OF AMERICA, DEFENDANT

[Filed: May 2, 1989]

COMPLAINT

Plaintiffs MCorp, MCorp Financial, Inc. ("MCorp Financial") and MCorp Management, debtors in possession in these chapter 11 cases (collectively, the "debtors"), by their attorneys, Weil, Gotshal & Manges, as and for their

complaint against the Board of Governors of the Federal Reserve System of the United States of America (the "Board"), aver as follows:

Summary of Relief Requested

1. On March 21, 1989, three creditors of MCorp commenced an involuntary case under chapter 7 of title 11 of the United States Code (the "Bankruptcy Code") against MCorp (the "Involuntary Petition") in the United States Bankruptcy Court for the Southern District of New York (the "New York Bankruptcy Court"). On March 31, 1989, MCorp Financial and MCorp Management each filed with this Court a voluntary petition for relief under chapter 11 of the Bankruptcy Code. Later that day, upon application of MCorp, the New York Bankruptcy Court ordered the case commenced by the Involuntary Petition converted to a case under chapter 11 pursuant to section 706(a) of the Bankruptcy Code and entered an order for relief under chapter 11 upon consent of MCorp.

2. By order dated April 4, 1989, the New York Bankruptcy Court granted MCorp's motion to transfer its chapter 11 case to this Court. By orders dated March 31, 1989 and April 20, 1989, the chapter 11 cases of MCorp, MCorp Financial and MCorp Management are being jointly administered in accordance with Rule 1015 "Bankruptcy Rules").

3. Each of the Debtors is operating its business and managing its properties pursuant to sections 1107(a) and 1108 of the Bankruptcy Code.

4. Pursuant to this Complaint, the Debtors seek an order and judgment (1)(a) declaring that certain administrative proceedings heretofore initiated by the Board are stayed pursuant to the automatic stay extant under section 362(a) of the Bankruptcy Code or, in the alternative, (b) permanently enjoining and restraining the Board from continuing the prosecution of such administrative proceedings pursuant to section 105(a) of

the Bankruptcy Code, and (2) permanently enjoining and restraining the Board from commencing any further administrative proceedings against the Debtors except with the prior approval of the Court granted after notice to the Debtors and a hearing.

Jurisdiction, Venue and the Parties

5. This adversary proceeding is an action for injunctive relief pursuant to sections 105(a) and 362 of the Bankruptcy Code and Federal Rule of Civil Procedure 65, made applicable to this adversary proceeding by Bankruptcy Rules 7001 and 7065.

6. This Court has jurisdiction over this adversary proceeding pursuant to 28 U.S.C. §§ 157 and 1134, and venue is proper in this district pursuant to 28 U.S.C. § 1409.

7. This adversary proceeding is a "core proceeding" pursuant to 28 U.S.C. § 157(b)(2)(A) and (O).

8. Plaintiff MCorp is a corporation organized and existing under the laws of the State of Delaware with principal places of business at 910 Travis Street, Houston, Texas 77252 and 1717 Main Street, Dallas, Texas 75201.

9. Plaintiff MCorp Financial is a corporation organized and existing under the laws of the State of Delaware, with its principal place of business at 1105 North Market Street, Wilmington, Delaware 19801, and is a wholly owned subsidiary of MCorp.

10. Plaintiff MCorp Management is a corporation organized and existing under the laws of the State of Nevada, with principal places of business at 910 Travis Street, Houston, Texas 77252 and 1717 Main Street, Dallas, Texas 75201, and is a wholly owned subsidiary of MCorp Financial.

11. Defendant Board is an agency or instrumentality of the United States of America, which may be served with process herein by service of the Summons and Com-

plaint on Henry K. Oncken, United States Attorney for the Southern District of Texas, 515 Rusk Avenue, Houston, Texas, by sending a copy thereof by registered mail to Richard Thornburgh, Attorney General of the United States, Washington, D.C., and by sending a copy thereof by certified mail to the Board in Washington, D.C.

Background of the Debtors

12. Prior to the actions taken by certain federal banking regulators on March 28 and 29, 1989 that are described below, MCorp and its subsidiaries comprised a banking and financial services enterprise, which, among other things, owned and operated twenty-five MBanks with approximately 85 branch offices serving approximately 33 communities in the State of Texas.

13. As of December 31, 1988, the MCorp banking subsidiaries had combined assets totalling more than $17 billion.

14. MCorp is a holding company principally for MCorp Financial which, in turn, is the holding company for MCorp Management, the MBanks and substantially all of MCorp's other non-debtor subsidiaries. MCorp Management provides management and technical services for the MBanks and other MCorp subsidiaries.

Efforts to Recapitalize

15. To offset the continuing losses from the prolonged deterioration of asset values in the depressed Texas economy and the consequent need to make substantial allowances for possible loan losses, beginning in the Fall of 1987 MCorp attempted to recapitalize, without federal assistance, through the sale of assets and the issuance of new securities. By the Spring of 1988, however, MCorp's efforts to recapitalize without federal assistance were frustrated, in large part, due to the financial difficulties then being experienced by several other major Texas banks.

16. As a consequence, MCorp approached the Federal Deposit Insurance Corporation (the "FDIC") concerning a federal assistance package. Throughout the Summer of 1988, MCorp attempted in vain to conduct substantive negotiations with the FDIC concerning a global recapitalization of the MBanks that would include FDIC assistance.

17. On October 7, 1988, in furtherance of its discussions with the FDIC concerning a recapitalization plan, MCorp made a formal request to the FDIC for open bank assistance for the MBanks (the "MCorp Assistance Plan"). The MCorp Assistance Plan provided for, among other things, the infusion into the MBanks of MCorp's existing liquid assets and FDIC assistance to the MBanks, along with substantial private investment in MCorp to recapitalize the holding companies.

The Board's Regulatory Actions

18. Despite continuous discussions with the Board and the FDIC regarding an overall resolution of MCorp's problems, and without any prior notice to MCorp, on October 19, 1988, the Board issued a notice of charges (the "First Notice of Charges") and two temporary cease and desist orders (the "Initial Temporary Orders") against MCorp. These administrative actions prohibited MCorp, without the consent of the Board, from (a) paying any cash dividends to its stockholders and (b) engaging in any transaction that would have the effect of dissipating MCorp's assets, other than (1) interest payments or principal reductions on any outstanding debt that MCorp was obligated to make pursuant to contractual obligations in effect as of October 19, 1988, (2) salaries or (3) payments for goods and services that MCorp was obligated to make pursuant to contractual obligations in effect as of October 19, 1988. Copies of the First Notice of Charges and the Initial Temporary Orders are annexed hereto as Exhibits A and B, respectively.

19. According to the First Notice of Charges:

> MCorp and its management have engaged, are engaging, and unless restrained, will continue to engage in unsafe and unsound practices that have weakened and will continue to weaken seriously the condition of MCorp and the Subsidiary Banks and are likely to cause substantial dissipation of the assets of MCorp that could be used to allow MCorp to serve as a source of financial strength for the Subsidiary Banks.

First Notice of Charges at ¶ 6. Such allegations and the Initial Temporary Orders based thereon were wholly without any factual or legal basis, in that not only had MCorp not taken any action which reasonably could lead the Board to believe that MCorp intended to dissipate its assets, but it had made substantial efforts and was planning to take additional steps to conserve its assets and it had so advised the Board.

20. On October 24, 1988, MCorp publicly announced a moratorium, effective as of October 21, 1988, on the payment of all principal of and interest on all of its approximately $470 million of senior and subordinated debt obligations. It took this step despite the fact that no such action was required by the Initial Temporary Orders or requested pursuant to the First Notice of Charges. By these actions, MCorp sought to preserve its assets for use in connection with a global recapitalization and assistance plan.

21. Although MCorp was in full compliance with the Initial Temporary Orders, late in the afternoon of October 26, 1988 (again without any prior indication to MCorp), the Board issued an "amended" notice of charges (the "Amended Notice of Charges") and a third temporary cease and desist order (the "Third Temporary Order") against MCorp. Copies of the Amended Notice of Charges and the Third Temporary Order issued pursuant thereto are annexed hereto as Exhibits

C and D, respectively.[1] The Amended Notice of Charges sought, among other things, to require MCorp to "implement an acceptable capital plan that would ensure that all of MCorp's available assets are used to recapitalize the [MBanks] that are suffering capital deficiencies." Amended Notice of Charges at ¶ 9(d).

22. Pending the outcome of the administrative proceedings contemplated by the Amended Notice of Charges, the Third Temporary Order required MCorp to "take such actions as are necessary to use all of its assets to provide capital support to [MBanks] in need of additional capital" and to report to the Board, within 15 days of October 26, 1988, the identity of each MBank into which capital would be infused and the amount of capital to be infused into each such MBank. Third Temporary Order at ¶ 1. These actions were coordinated with the issuance on October 27, 1988 of certain notices of intent by the Comptroller of the Currency of the United States of America (the "Comptroller") to issue capital directives to require eighteen of the MBanks to achieve a minimum level of primary capital.

23. At the time that the October Notices of Charges and the Temporary Orders were issued, the Board knew that MCorp's available liquid assets were approximately $250 million and that the need of the MBanks for additional capital and financial assistance was substantially in excess of available resources, thus making any capital infusion into the MBanks of MCorp's liquid assets, without additional FDIC assistance, a futile gesture by MCorp and a waste of its assets to the detriment of MCorp's creditors and stockholders. In view of such facts, the Board's actions suggest that the Board would

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[1] The First Notice of Charges and the Amended Notice of Charges are sometimes referred to herein collectively as the "October Notices of Charges". The Initial Temporary Orders and the Third Temporary Order are sometimes referred to herein collectively as the "Temporary Orders".

not consider fairly the interests of the Debtors' creditors and stockholders in any administrative proceeding.

24. If MCorp had complied with the Third Temporary Order and had downstreamed or contributed its assets to the undercapitalized MBanks, that action would have exposed MCorp and its officers and directors to substantial claims by creditors and stockholders for fraudulent conveyances, corporate waste and mismanagement and MCorp had so previously advised the Board.

25. On November 3, 1988, MCorp filed a First Amended Complaint and Application for Injunction against the Board in the United States District Court for the Northern District of Texas, Dallas Division, seeking a preliminary injunction suspending or setting aside the Temporary Orders on the grounds that, *inter alia*, (a) the Temporary Orders were invalid and without basis in law or fact, (b) the pendency of the Temporary Orders was damaging both the prospects for a federally assisted recapitalization plan for the MBanks and public confidence in MCorp and the MBanks and (c) if the transfers contemplated by the Third Temporary Order were made it would be a violation of MCorp's fiduciary, statutory and contractual duty to its stockholders and creditors. A copy of MCorp's Amended Complaint and Application for Injunction is annexed hereto as Exhibit E. By order dated March 7, 1989, the District Court that the action commenced by the Amended Complaint be stayed until May 2, 1989, without prejudice to either party.

26. After extended negotiations, which started on October 27, 1988 and continued over the weekend of November 5, 1988, MCorp and all of the federal regulators, including the Board, reached a standstill agreement, the terms of which were embodied in a letter agreement between MCorp and the FDIC dated November 6, 1988 (the "Standstill Agreement"). A copy of the Standstill Agreement is annexed hereto as Exhibit F. Among other things, pursuant to the Standstill Agreement, the FDIC

agreed to commence, at once, negotiations with MCorp concerning the MCorp Assistance Plan, while at the same time proposals would be solicited by the FDIC over a ten-week period from third parties for recapitalization of MCorp and assistance for the MBanks. As part of the Standstill Agreement, MCorp agreed to use all reasonable efforts to (a) assure that traditional inter-bank funding relationships of the MBanks were maintained, (b) refrain from filing a voluntary bankruptcy petition and prevent the commencement of an involuntary bankruptcy case and (c) cooperate with the FDIC's solicitation of third-party proposals.

27. In conjunction with the Standstill Agreement, on November 7, 1988, the Board agreed to (a) defer the time for submission of the report of capital injections required by the Third Temporary Order until five days following notice to MCorp from the Board, (b) postpone the administrative and any judicial proceedings relating to the October Notices of Charges and Third Temporary Order for thirty days from their scheduled dates, and (c) extend the time to file an answer to the First Notice of Charges to November 11, 1988 (the "Standstill Letter"). A copy of the Standstill Letter is annexed hereto as Exhibit G.

28. Over the course of the next ten weeks and, indeed, through the date hereof, MCorp cooperated with the federal regulators and fulfilled its obligations on a timely basis under the Standstill Agreement.

The Seizing of the Banks

29. In contrast to MCorp's conscientious compliance with the letter and spirit of the Standstill Agreement and despite the FDIC's commitment to negotiate in good faith with MCorp, the FDIC never entered into or conducted substantive negotiations with MCorp or attempted in good faith to develop or discuss with MCorp a recapitalization and assistance transaction.

30. Forty-eight hours after MCorp provided notice of the Involuntary Petition to the federal regulators, and in disregard of the Standstill Agreement, late in the evening of March 28, 1989, and early in the morning of March 29, the Comptroller issued *ex parte* orders declaring insolvent twenty of the twenty-five MBanks, including MBank Dallas, N.A. ("MBank Dallas") and MBank Houston, N.A. ("MBank Houston"), and appointing the FDIC as receiver for such MBanks. Thereafter, the FDIC obtained *ex parte* orders from United States District Courts in all Texas districts approving the transfer of certain deposits and other liabilities, and certain assets of the receivership estates of the twenty MBanks to The Deposit Insurance Bridge Bank, National Association (the "DIBB"), a newly created entity wholly owned by the FDIC.

31. MCorp and MCorp Financial have filed an action against the Comptroller and the FDIC in United States District Court for the Northern District of Texas, Dallas Division, asserting, among other things, that the FDIC and the Comptroller, in seizing at least twelve solvent MBanks, exceeded their statutory authority and wrongfully deprived MCorp and MCorp Financial of their property without just compensation. A copy of the First Amended Complaint in that action is annexed hereto as Exhibit H.

32. Following these precipitous events, MCorp was left with only five MBanks (the "Remaining MBanks"), with a net book value as of December 31, 1988 of approximately $125 million and other banking and nonbanking assets around which to reorganize.

The March Notice of Charges and the MNet Transaction

33. Within one day after the Comptroller seized the twenty MBanks, the Board commenced, by a notice of charges dated March 30, 1989 (the "March Notice of Charges"), administrative proceedings against MCorp

Management and its indirect parent, MCorp. A copy of the March Notice of Charges is annexed hereto as Exhibit I. Despite the seizing by the Comptroller and the FDIC of MBank Houston and MBank Dallas, the March Notice of Charges alleges that MCorp and MCorp Management have engaged, are engaging and, unless restrained, *will continue* to engage in violations of section 23A of the Federal Reserve Act, 12 U.S.C. § 371c, in that Corp and MCorp Management allegedly caused MBank Houston and MBank Dallas to provide MCorp Management "unsecured extensions of credit." March Notice of Charges at ¶ 5. Moreover, the March Notice of Charges alleges that MCorp and MCorp Management

> have engaged, are engaging and, unless restrained, *will continue* to engage in unsafe and unsound practices in that (a) MCorp and MCorp Management have failed to cause MBank Dallas and MBank Houston to record or report properly on their books and financial statements the amounts due from MCorp Management on the unsecured extensions of credit . . ., (b) MCorp Management has not properly recorded or reported on its books and financial statements the unsecured extensions of credit from these two Subsidiary Banks, and (c) MCorp Management had failed to account properly for the arrearages totalling over $14 million that are due to MBank Dallas and MBank Houston and has failed to record or report such arrearages on its books and financial statements.

March Notice of Charges at ¶ 6 (emphasis supplied). The March Notice of Charges does not specify the relief the Board is seeking, but states only that the Board will seek the entry of "an appropriate order . . . requiring MCorp and MCorp Management to cease and desist from the practices and violations specified [therein] or to take such affirmative action as may be appropriate under the circumstances of this matter." March Notice of Charges

at ¶ 9. In their Answer to the March Notice of Charges, dated April 19, 1989, MCorp and MCorp Management challenge the authority of the Board to bring such actions and dispute the Board's characterizations of the relevant transactions as "extensions of credit" in violation of section 23A of the Federal Reserve Act. A copy of the Answer of MCorp and MCorp Management to the March Notice of Charges is annexed hereto as Exhibit J. Moreover, MCorp and MCorp Management deny that MCorp Management is in arrears on any obligation it may have to the FDIC in its capacity as receiver of Bank Dallas and MBank Houston or to the DIBB, as transferee from the receivership estates of MBank Dallas and MBank Houston of any such claims against MCorp Management. In fact, MCorp and MCorp Management believe that MCorp Management owes nothing to such MBanks because of the offsetting of the balances owing by such former MBanks to MCorp Management.

34. The alleged "unsecured extensions of credit" and "unsafe and unsound practices" in the March Notice of Charges relate to a transaction—the "MNet Transaction"—which occurred more than two years ago. Prior to the MNet Transaction, on August 1, 1985, MBank Houston and MBank Preston, N.A. ("MBank Preston"), which subsequently was merged into MBank Dallas, sold certain assets of their credit card operations to MBank USA, a wholly owned subsidiary of MNet Corp ("MNet") which, in turn, was a wholly owned subsidiary of MCorp Financial. In connection with the sale of their credit card operations, and to fund the ongoing operations of MBank USA, MBank Houston and MBank Preston sold federal funds in the approximate aggregate amount of $364 million to MBank USA "until further notice"[2] pursuant to letter agreements dated August 1,

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[2] Banks routinely buy and sell federal funds. In an "until further notice" federal funds transaction, the selling bank typically agrees to transfer to the buying bank a specified amount of federal

1985 and October 1, 1985 (collectively, the "Letter Agreements"), copies of which are annexed hereto as Exhibits K and L, respectively. In exchange for the use of such funds, MBank USA agreed to (a) repay the principal amount of and interest due on such federal funds upon receipt of demand and (b) pay as "Additional Contingent Fees" the lesser of a specified sum or a sum equal to a percentage of MBank USA's monthly net income until the earlier of (i) payment of a specified amount to each particular bank or (ii) December 31, 1993. According to the terms of the Letter Agreements, MBank USA's obligation to pay Additional Contingent Fees survived the termination of the sale of federal funds and the repayment of principal and interest relating thereto.

35. Thereafter, in the MNet Transaction, MCorp Financial sold the capital stock of MNet to Lomas & Nettleton Financial Corporation ("L&N") in exchange for cash, promissory notes issued by L&N (the "L&N Notes"), Series B Preferred Stock of L&N the "L&N Preferred Stock") and common stock of L&N, all pursuant to a Stock Purchase Agreement dated as of November 16, 1986. In connection with such sale, MBank Houston and MBank Preston agreed to (a) terminate their respective federal funds transactions with MBank USA upon full repayment to them of the principal and accrued interest owed and (b) release MBank USA from its obligations to pay the Additional Contingent Fees. In consideration therefor, MBank Houston and MBank Preston requested a substitute contingent arrangement to compensate them for the Additional Contijngent Fees to which they originally were entitled.

36. To facilitate the sale of MNet to L&N and as a substitute contingent payment arrangement, MCorp Management agreed to pay MBank Houston and MBank Preston an aggregate amount equal to the lesser of (a)

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funds and, in exchange, the buying bank agrees to pay the selling bank interest at the Federal Funds rate and to re-transfer the federal funds upon demand.

the sum of the interest actually received by MCorp Management on the L&N Note and the dividends actually received by MCorp Management on the L&N Preferred Stock or (b) quarterly cash payments of $2,853,000 (the "Contingent Payments"). Like MBank USA's obligation to pay the Additional Contingent Fees for which the Contingent Payments were intended as a substitute, MCorp Management's obligation to make the Contingent Payments terminated on the earlier of payment in full of the amount of Additional Contingent Fees then due or December 31, 1993. Copies of the Agreements, each dated as of December 30, 1986, which embody the releases by MBank Houston and MBank Preston of MBank USA and the substitution of the Contingent Payments, are annexed hereto as Exhibits M and N, respectively.

37. In the March Notice of Charges, the Board attempts to characterize MCorp Management's obligation to make the Contingent Payments alternatively as "unsecured extensions of credit" to MCorp Management by MBank Preston and MBank Houston (March Notice of Charges at ¶ 5(b)(1)) or as a repayment of "unsecured extensions of credit" (March Notice of Charges at ¶ 5(a)(1)). There is no basis in law or fact to characterize the Contingent Payments as extensions of credit for at least two independent reasons. First, the Contingent Payments merely represent an override on amounts that MCorp Management may or may not receive as interest and dividends on the L&N Notes and L&N Preferred Stock, with a defined maximum amount of $2,583,000 quarterly. Second, the Contingent Payments cannot be considered "extensions of credit" because no funds or other property of MBank Houston and MBank Preston were ever received by MCorp Management in exchange or consideration for the Contingent Payments. All general indicia of an "extension of credit," such as the commitment of the assets of the party extending credit, the presence of consideration to

the creditor for the extension, a date certain for payment and a fixed unconditional obligation to repay any sums committed, are absent from the agreements with MCorp Management pursuant to which the Contingent Payments are to be made.

The Board's Continued Prosecution of the Administrative Proceedings Is Not Appropriate in the Context of the Debtors' Chapter 11 Cases

38. The pendency of the Debtors' chapter 11 cases renders the October Notices of Charges and the Temporary Orders moot for the following reasons:

(a) By virtue of the filing of the Chapter 11 cases and pursuant to the provisions of chapter 11 of the Bankruptcy Code, the Debtors may not pay dividends to the holders of MCorp's common or preferred stock.

(b) Under no circumstances may the Debtors dissipate or transfer their assets or make any payments with respect to prepetition claims except pursuant to an order of this Court or a confirmed chapter 11 plan.

(c) The actions of the Comptroller in declaring twenty MBanks insolvent and placing them in the hands of the FDIC renders the balance of the charges in the October Notices of Charges and the Temporary Orders moot because the remaining MBanks have not been determined to be in need of an infusion of capital.

39. Continued prosecution of the October Notices of Charges or enforcement of the Temporary Orders would constitute a blatant attempt by the Board to exert control over the Debtors' assets, in the face of this Court's exclusive jurisdiction over the Debtors' property, wherever located, and in derogation of the rights, claims and interests of the creditors and stockholders of the Debtors and, therefore, should not be permitted.

40. The March Notice of Charges is moot in view of the fact that whatever MCorp and MCorp Management did occurred before the commencement of these chapter 11 cases and relates to banks closed by the Comptroller, over which the Debtors no longer have any control.

41. Moreover, the administrative proceeding initiated by the March Notice of Charges is not an action in furtherance of the Board's regulatory functions. Indeed, as MCorp and MCorp Management allege in their Answer to the March Notice of Charges, the Board has no statutory authority to bring an action against MCorp and MCorp Management under section 23A of the Federal Reserve Act and exceeded its authority under 12 U.S.C. § 1818(b). In any event, any cease and desist order which might result would necessarily be meaningless because the only MBanks involved are no longer under MCorp's control. Rather, the March Notice of Charges constitutes an attempt by the Board to bolster the alleged claims against the Debtors held either by the FDIC, as receiver for MBank Houston and MBank Dallas or by the DIBB.

42. In essence, the March Notice of Charges involves, at most, a "garden variety" commercial dispute with a chapter 11 debtor over whether certain prepetition claims asserted by the Board (for the apparent benefit of the FDIC) should be allowed. The Board, if permitted to proceed, will be directly adjudicating the validity of a prepetition claim and the exercise of a prepetition offset. Such determinations clearly fall within the province and jurisdiction of this Court under 28 U.S.C. § 1334(b), not in the regulatory administrative tribunal. To the extent that the Board, via administrative proceedings, seeks something more than a determination of the FDIC's claim, the proceeding is an effort to harass the Debtors and embarass this Court and its exclusive jurisdiction over the property of these Debtors under 28 U.S.C. § 1334(d).

FIRST CAUSE OF ACTION
(JUDGMENT DECLARING THAT PURSUANT TO 11 U.S.C. § 362(a) THE BOARD IS STAYED FROM PROSECUTING THE OCTOBER NOTICES OF CHARGES AND ENFORCING THE TEMPORARY ORDERS)

43. Plaintiffs repeat and reaver the averments set forth in Paragraphs 1 through 42 as if fully set forth herein.

44. Under section 362(a) of the Bankruptcy Code, the filing of a petition for relief operates as a stay, applicable to all entities, including government agencies, of any act to obtain possession of property of the Debtors' estates or of property from the estates or to exercise control over property of the estate. Continued prosecution of the October Notices of Charges and enforcement of the Temporary Orders, even though the issues raised by them are moot, would constitute an attempt to exert direct control over property of the Debtors' estates in violation of section 362(a). Furthermore, since the charges made in the October Notices of Charges do not involve the public health, safety or morals, there is no exception from the automatic stay under section 362(b) for such acts.

45. Accordingly, the Debtors are entitled to a judgment declaring that the administrative proceedings commenced by the October Notices of Charges Notices of Charges are subject to the automatic stay under section 362 of the Bankruptcy Code and restraining and enjoining the Board from (a) prosecuting the October Notices of Charges and (b) enforcing the Temporary Orders.

SECOND CAUSE OF ACTION (INJUNCTION PURSUANT TO 11 U.S.C. § 105 ENJOINING THE BOARD FROM PROSECUTING THE OCTOBER NOTICES OF CHARGES AND ENFORCING THE TEMPORARY ORDERS)

46. Plaintiffs repeat and reaver the averments set forth in Paragraphs 1 through 45 as if fully set forth herein.

47. Pursuant to section 105(a) of the Bankruptcy Code and Federal Rule of Civil Procedure 65, made applicable to this adversary proceeding pursuant to Bankruptcy Rules 7001 and 7065, this Court may issue any order that is necessary or appropriate to carry out the provisions of the Bankruptcy Code, including an injunction necessary to preserve or protect the Debtors and their estates for the benefit of their creditors and stockholders, to protect the exclusive jurisdiction of this Court over the Debtors and their assets wherever located, and to insure that the provisions of the Bankruptcy Code are carried out.

48. The October Notices of Charges and the Temporary Orders seek to compel the Debtors to take or refrain from taking actions which pursuant to the Bankruptcy Code they are already prohibited from taking without this Court's prior approval or pursuant to a confirmed chapter 11 plan. Moreover, the October Notices of Charges and the Temporary Orders seek to compel the Debtors to contribute assets to MBanks which are no longer under the direct or indirect control of MCorp. Thus, the relief sought by the Board pursuant to the October Notices of Charges and the Temporary Orders is moot in view of the pending Chapter 11 cases.

49. If the Board is permitted to pursue administrative proceedings to wrest control of the Debtors' assets from *custodia legis*, the Debtors will have been stripped of substantial liquid assets that would form an integral part of any chapter 11 plan without the due process protections, including notice and an opportunity to be heard, afforded the Debtors and their creditors, stockholders and other parties in interest by the Bankruptcy Code. The continuation of such administrative proceedings will also divert the time and energies of the Debtors' personnel and professionals from their primary taks of pursuing the rehabilitation of the Debtors and the formulation of reorganization plans for the Debtors and the expenses incurred to defend such administrative proceedings will be an unnecessary and wasteful financial drain on those

Debtors' estates. At the very outset of their chapter 11 cases, the Debtors' efforts to reorganize would be crippled. The foregoing averments amply demonstrate the substantial and irreparable injury and prejudice that the Debtors and their estates and creditors will suffer unless the Board is restrained from prosecuting the October Notices of Charges, enforcing the Temporary Orders or taking any other administrative action seeking to control property of the Debtors' estates.

50. Accordingly, the Debtors are entitled to the issuance of an injunction pursuant to section 105(a) of the Bankruptcy Code and Federal Rule of Civil Procedure 65 enjoining and restraining the Board from (a) prosecuting the October Notices of Charges, (b) enforcing the Temporary Orders and (c) otherwise commencing a proceeding or action to obtain a cease and desist order or other relief against any of the Debtors or property of the Debtors' estates without prior approval of the Court after notice and a hearing.

THIRD CAUSE OF ACTION (JUDGMENT DECLARING THAT PURSUANT TO 11 U.S.C. § 362 THE BOARD IS STAYED FROM PROSECUTING THE MARCH NOTICE OF CHARGES)

51. Plaintiffs repeat and reaver the averments set forth in Paragraphs 1 through 50 as if fully set forth herein.

52. Under section 362(a) of the Bankruptcy Code, the filing of a petition for relief under the Bankruptcy Code operates as a stay, applicable to all entities, against the commencement or continuation of any judicial or administrative action against the debtor that was or could have been commenced before the commencement of the bankruptcy case or to recover a claim against the debtor that arose before the commencement of the case and of any act to obtain possession of property of the debtor's

estate or of property from the estate or to exercise control over the debtor's property.

53. The commencement of the administrative proceedings pursuant to the March Notice of Charges is an administrative action which could have been commenced prepetition and relates solely to alleged prepetition conduct and actions of MCorp and MCorp Management and, thus, violates the automatic stay pursuant to section 362(a) of the Bankruptcy Code.

54. Section 362(b) of the Bankruptcy Code does not exempt the Board's administrative proceedings pursuant to the March Notice of Charges from the automatic stay because such proceedings are not actions to enforce the type of police or regulatory power exempted by section 362(b). Rather, such administrative proceedings constitute an attempt by the Board to establish and support alleged prepetition claims now held either by the FDIC as receiver for MBank Dallas and MBank Houston or the DIBB and, carried to their logical conclusion, an attempt by the Board to obtain possession of property of the Debtors' estates.

55. Accordingly, the Debtors are entitled to a judgment declaring that the administrative proceedings commenced by the March Notice of Charges are enjoined pursuant to section 362(a) of the Bankruptcy Code and restraining and enjoining the Board from prosecuting the March Notice of Charges.

FOURTH CAUSE OF ACTION (INJUNCTION PURSUANT TO 11 U.S.C. § 105 (a) ENJOINING THE BOARD FROM PROSECUTING THE MARCH NOTICE OF CHARGES)

56. Plaintiffs repeat and reaver the averments set forth in Paragraphs 1 through 55 as if fully set forth herein.

57. As stated, pursuant to section 105(a) and Federal Rules of Civil Procedure 65, made applicable to this adversary proceeding pursuant to Bankruptcy Rules 7001

and 7065, this Court may issue any order that is necessary or appropriate to carry out the provisions of the Bankruptcy Code.

58. The Debtors submit that the foregoing averments establish that the Debtors, their estates and creditors will suffer substantial and irreparable injury and prejudice unless the Board is enjoined from prosecuting the administrative procedings initiated pursuant to the March Notice of Charges. Permitting the Board to proceed will allow the Board to determine the amount of a claim held by another federal agency or the DIBB resulting in a piecemeal determination of claims in derogation of the procedures and protections established under the Bankruptcy Code. Moreover, defending the administrative proceedings will divert the valuable attention and limited economic, personnel and professional resources from the larger and more important goals of rehabilitating the Debtors and preserving the Debtors' estates for the benefit of all creditors and successfully reorganizing.

59. Accordingly, the Debtors are entitled to the issuance of an injunction pursuant to section 105(a) of the Bankruptcy Code and Federal Rule of Civil Procedure 65 enjoining the Board from continuing to prosecute the March Notice of Charges.

WHEREFORE, the Debtors respectfully request that the Court enter an order and judgment (1) (a) declaring that the administrative proceedings initiated by the Board pursuant to the October Notices of Charges and the March Notice of Charges are subject to the automatic stay extant pursuant to section 362(a) of the Bankruptcy Code and restraining and enjoining the Board from prosecuting such administrative actions and enforcing the Temporary Orders, or, in the alternative, (b) restraining and enjoining the Board from prosecuting the October Notices of Charges and the March Notice of Charges and enforcing the Temporary Orders, pursuant to section 105(a) of the Bankruptcy Code, (2) restraining and enjoining the Board from commencing any further administrative proceedings or action to obtain or enforce a cease and desist order or other relief against any of the Debtors or any property of the Debtors' estates without the prior approval of this Court after notice and a hearing, and (3) granting to the Debtors such other and further relief as may be just and proper under the circumstances.

Dated: Houston, Texas
Dated: May 2, 1989

By: /s/ D. J. Baker
D. J. BAKER
Attorney-in-Charge
Admission No. 2041
1600 First RepublicBank Center
700 Louisiana
Houston, Texas 77002
(713) 546-5000

Attorneys For MCorp, MCorp Financial, Inc. and MCorp Management, as Debtors and Debtors in Possession

Of Counsel:

ALAN B. MILLER, ESQ.
WEIL, GOTSHAL & MANGES
1600 First RepublicBank Center
700 Louisiana
Houston, Texas 77002
(713) 546-5000

-and-

767 Fifth Avenue
New York, New York 10153
(212) 310-8000

-and-

THOMAS W. LUCE III, ESQ.
HUGHES & LUCE
2800 Momentum Place
1717 Main Street
Dallas, Texas 75201
(214) 959-5500

-and-

JOHN D. HAWKE, JR.
ARNOLD & PORTER
Thurman Arnold Building
1200 New Hampshire Avenue, N.W.
Washington, D.C. 20036
(202) 872-6700

UNITED STATES BANKRUPTCY COURT
SOUTHERN DISTRICT OF TEXAS
HOUSTON DIVISION

Jointly Admin. Chap. 11 Case Nos. 89-02312-H3-11,
89-02324-H5-11, and 89-02848-H2-11
Adversary Proc. No. 89-0298

IN RE: MCORP FINANCIAL, INC., ETC.,
MCORP MANAGEMENT, AND MCORP, ETC., DEBTORS.

MCORP, MCORP FINANCIAL, INC., AND MCORP
MANAGEMENT, DEBTORS IN POSSESSION, PLAINTIFFS

v.

THE BOARD OF GOVERNORS OF THE FEDERAL RESERVE
SYSTEM OF THE UNITED STATES OF AMERICA, DEFENDANT

[Filed: May 2, 1989]

**EMERGENCY MOTION PURSUANT TO
FEDERAL RULE OF CIVIL PROCEDURE 65
AND BANKRUPTCY RULE 7065
FOR TEMPORARY RESTRAINING ORDER
AND PRELIMINARY INJUNCTION**

TO THE HONORABLE LETITIA Z. CLARK,
UNITED STATES BANKRUPTCY JUDGE:

Plaintiffs MCorp, MCorp Financial, Inc. ("MCorp Financial") and MCorp Management, debtors in possession in these chapter 11 cases (collectively, the "Debtors"),

as and for their Motion for a temporary restraining order and a preliminary injunction against the defendant, the Board of Governors of the Federal Reserve System of the United States of America (the "Board"), pursuant to Federal Rule of Civil Procedure 65, made applicable to this adversary proceeding pursuant to Rules 7001 and 7065 of the Federal Rules of Bankruptcy Procedure (the "Bankruptcy Rules"), respectfully represent:

BACKGROUND

1. On March 21, 1989, three creditors of MCorp commenced an involuntary case under chapter 7 of title 11 of the United States Code (the "Bankruptcy Code") against MCorp (the "Involuntary Petition") in the United States Bankruptcy Court for the Southern District of New York (the "New York Bankruptcy Court"). On March 31, 1989, MCorp Financial and MCorp Management each filed with this Court a voluntary petition for relief under chapter 11 of the Bankruptcy Code. Later that day, upon application of MCorp, the New York Bankruptcy Court ordered the case commenced by the Involuntary Petition converted to a case under chapter 11 pursuant to section 706(a) of the Bankruptcy Code and entered an order for relief under chapter 11 upon consent of MCorp.

2. By order dated April 4, 1989, the New York Bankruptcy Court granted MCorp's motion to transfer its chapter 11 case to this Court. By orders dated March 31, 1989 and April 20, 1989, the chapter 11 cases of MCorp, MCorp Financial and MCorp Management are being jointly administered in accordance with Bankruptcy Rule 1015.

3. MCorp and its subsidiaries comprise a banking and financial services enterprise. As of December 31, 1988, MCorp banking subsidiaries had combined assets in excess of approximately $17 billion. MCorp is a holding company principally for MCorp Financial which, in turn, is the holding company for MCorp Management, the

MBanks and substantially all of MCorp's other non-debtor subsidiaries. MCorp Management provides management and technical services for the MBanks and other MCorp subsidiaries.

4. Each of the Debtors is operating its business and managing its properties pursuant to sections 1107(a) and 1108 of the Bankruptcy Code.

The October Notices of Charges

5. On October 19, 1988, the Board issued a notice of charges (the "First Notice of Charges") and two temporary cease and desist orders (the "Initial Temporary Orders") against MCorp.[1] According to the First Notice of Charges:

> MCorp and its management have engaged, are engaging, and, unless restrained, will continue to engage in unsafe and unsound practices that have weakened and will continue to weaken seriously the condition of MCorp and the Subsidiary Banks and are likely to cause substantial dissipation of the assets of MCorp that could be used to allow MCorp to serve as a source of financial strength for the Subsidiary Banks.

First Notice of Charges at ¶ 6. The First Notice of Charges established December 12, 1988 as the date on which a hearing would be held before an administrative law judge designated by the Board to take evidence on the charges and determine "whether requiring MCorp to cease and desist from the unsafe and unsound practices specified [therein] or to take affirmative action to correct the conditions resulting from such unsafe and unsound practices." First Notice of Charges at ¶ 8.

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[1] Copies of the relevant documents referred to herein are annexed to the Affidavit of Gene H. Bishop in Support of the Motion dated May 1, 1989 (the "Affidavit"), and are incorporated herein by reference.

6. Pending the completion of the administrative proceedings initiated by the First Notice of Charges, the Initial Temporary Orders prohibited MCorp, without the consent of the Board, from (a) paying any cash dividends to its stockholders and (b) engaging in any transaction that would have the effect of dissipating MCorp's assets, other than (1) interest payments or principal reductions on any outstanding debt that MCorp was obligated to make pursuant to contractual obligations in effect as of October 19, 1988, (2) salaries or (3) payments for goods and services that MCorp was obligated to make pursuant to contractual obligations in effect as of October 19, 1988.

7. Although MCorp was in full compliance with the Initial Temporary Orders, on October 26, 1988, the Board issued an "amended" notice of charges (the "Amended Notice of Charges") and a third temporary cease and desist order (the "Third Temporary Order") against MCorp.[2] The Amended Notice of Charges sought, among other things, to require MCorp to "implement an acceptable capital plan that would ensure that all of MCorp's available assets are used to recapitalize the [MBanks] that are suffering capital deficiencies." Amended Notice of Charges at ¶ 9(d).

8. Pending the outcome of the administrative proceedings contemplated by the Amended Notice of Charges, the Third Temporary Order required MCorp to "take such actions as are necessary to use all of its assets to provide capital support to [MBanks] in need of additional capital" and to report to the Board, within 15 days of October 26, 1988, the identity of each MBank into which capital would be infused and the amount of capital to be infused into each such MBank. Third Temporary Order at ¶ 1.

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[2] The First Notice of Charges and the Amended Notice of Charges are sometimes referred to herein collectively as the "October Notices of Charges". The Initial Temporary Orders and the Third Temporary Order are sometimes referred to herein collectively as the "Temporary Orders".

9. In response to the Temporary Orders, on November 3, 1988, MCorp filed a First Amended Complaint and Application for Injunction against the Board in the United States District Court for the Northern District of Texas, Dallas Division, seeking a preliminary injunction suspending or setting aside the Temporary Orders on the grounds that the Temporary Orders were without basis in law or fact. Indeed, MCorp alleged that compliance with the Third Temporary Order required it to violate its fiduciary, statutory and contractual duties to its stockholders and creditors. Furthermore, MCorp alleged that the pendency of the Temporary Orders damaged the prospects for a federally assisted recapitalization plan for the MBanks which MCorp was attempting to negotiate with the Federal Deposit Insurance Corporation (the "FDIC") and undermined public confidence in MCorp and the MBanks.

10. After extended negotiations, MCorp and all of the federal banking regulators, including the Board, reached a standstill agreement relating to the recapitalization plan, the terms of which were embodied in a letter agreement between MCorp and the FDIC dated November 6, 1988 (the "Standstill Agreement"). In conjunction with the Standstill Agreement, on November 7, 1988, the Board agreed to (a) defer the time for submission of the report of capital injections required by the Third Temporary Order until five days following notice to MCorp from the Board, (b) postpone the administrative and any judicial proceedings relating to the October Notices of Charges and the Third Temporary Order for thirty days from their scheduled dates ,and (c) extend the time to file an answer to the First Notice of Charges to November 11, 1988.

The Seizure of the MBanks

11. In disregard of the Standstill Agreement, late in the evening of March 28, 1989, and early in the morning of March 29, the Comptroller of the Currency of the United States of America (the "Comptroller"), acting in

concert with the Board and the FDIC, issued *ex parte* orders declaring insolvent twenty of the twenty-five MBanks, including MBank Dallas, N.A. ("MBank Dallas") and MBank Houston, N.A. ("MBank Houston"), and appointing the FDIC as receiver for such MBanks. Thereafter, the FDIC obtained *ex parte* orders from United States District Courts in all four Texas districts approving the transfer of certain deposits and other liabilities and certain assets of the receivership estates of the twenty MBanks to The Deposit Insurance Bridge Bank, National Association (the "DIBB"), a newly created entity that is wholly owned by the FDIC.

12. Following these precipitous events, MCorp was left with only five MBanks (the "Remaining MBanks"), with a net book value as of December 31, 1988 of approximately $125 million and other banking and non-banking assets.

13. On March 31, 1989, MCorp and MCorp Financial filed an action against the Comptroller and the FDIC in United States District Court for the Northern District of Texas, Dallas Division, asserting, among other things, that the FDIC and the Comptroller, in seizing at least twelve solvent MBanks, exceeded their statutory authority and wrongfully deprived MCorp and MCorp Financial of their property without just compensation. Pursuant to the First Amended Complaint against the Comptroller and the FDIC filed on April 21, 1989, MCorp and MCorp Financial seek injunctive relief and damages in excess of $70 million.

The March Notice of Charges

14. Within one day after the Comptroller seized the twenty MBanks, the Board commenced, by a notice of charges dated March 30, 1989 (the "March Notice of Charges"), an administrative proceeding against MCorp and MCorp Management. The March Notice of Charges alleges that MCorp and MCorp Management have engaged, are engaging and, unless restrained, will continue

to engage in violations of section 23A of the Federal Reserve Act, 12 U.S.C. § 371c, in that MCorp and MCorp Management allegedly caused MBank Houston and MBank Dallas to provide MCorp Management "unsecured extensions of credit." March Notice of Charges at ¶ 5.[3] Moreover, the March Notice of Charges alleges that MCorp and MCorp Management have engaged, are engaging, and, unless restrained will continue to engage in "unsafe and unsound banking practices" in violation of 12 U.S.C. § 1818(b), in that they failed, and caused MBank Dallas and MBank Houston to fail, to properly account for the alleged "unsecured extensions of credit." March Notice of Charges at ¶ 6. The March Notice of Charges also alleges that "the commencement and continuation of the proceedings against MCorp or MCorp Management instituted by this Notice would be exempt from the automatic stay provisions of the Federal Bankruptcy Code." March Notice of Charges at ¶ 8.

15. By Answer dated April 19, 1989, MCorp and MCorp Management challenge the authority of the Board to bring the administrative proceeding contemplated by the March Notice of Charges and dispute the Board's characterization of the relevant transactions as "extensions of credit" in violation of section 23A of the Federal Reserve Act. Moreover, MCorp and MCorp Management deny that the administrative proceedings initiated by the Board's March Notice of Charges are exempt from the automatic stay or that MCorp Management is in arrears on any obligation it may have to the FDIC in its capacity as receiver of MBank Dallas and MBank Houston or to the DIBB as transferee of any such claims against MCorp Management from the receivership estates of MBank Dallas and MBank Houston. In fact, MCorp and MCorp Management believe that MCorp Management owes nothing to such MBanks because of the offsetting balances

[3] The transactions underlying the alleged "unsecured extensions of credit" are described in detail in the Affidavit.

owing by such former MBanks to MCorp Management. The hearing in respect of the March Notice of Charges before an administrative law judge designated by the Board has been set for May 29, 1989, unless stayed by this Court.

The Adversary Proceeding

16. Pursuant to the Complaint initiating the above-captioned adversary proceeding (the "Complaint"), the Debtors seek the entry of an order and judgment (1) (a) declaring that prosecution of the October and March Notices of Charges (collectively, the "Notices of Charges") and enforcement of the Temporary Orders are stayed pursuant to the automatic stay extant under section 362 (a) of the Bankruptcy Code or, in the alternative, (b) permanently enjoining and restraining the Board from continuing to prosecute the Notices of Charges or enforce the Temporary Orders pursuant to section 105(a) of the Bankruptcy Code, and (2) permanently enjoining and restraining the Board from commencing any further administrative proceedings against the Debtors except with the prior approval of the Court granted after notice to the Debtors and a hearing.

17. Under section 362(a) of the Bankruptcy Code, the filing of a petition for relief under the Bankruptcy Code operates as a stay, applicable to all entities, against the commencement or continuation of any judicial or administrative action against the debtor that was or could have been commenced before the commencement of the bankruptcy case or to recover a claim against the debtor that arose before the commencement of the case and of any act to obtain possession of property of the debtor's estate or of property from the estate or to exercise control over the debtor's property.

18. The October Notices of Charges and the Temporary Orders require MCorp to marshal all of its assets and seek to force MCorp to contribute substantially all

of its liquid asets to the MBanks. The March Notice of Charges, in substance, seeks to determine and recover a prepetition claim now held by the FDIC, as receiver for MBank Dallas and MBank Houston, or by the DIBB, as transferee of the alleged claims from the receivership estates of MBank Dallas and MBank Houston. Accordingly, continued prosecution of the Notices of Charges by the Board clearly violates the automatic stay under section 362(a). Furthermore, because the Notices of Charges do not in any manner implicate the public health, safety, welfare or morals, the Board's actions are not entitled to the benefits of the limited exceptions from the automatic stay under section 362(b).

19. Pursuant to section 105(a) of the Bankruptcy Code, this Court may issue any order that is necessary or appropriate to carry out the provisions of the Bankruptcy Code, including an injunction necessary to preserve or protect the Debtors and their estates for the benefit of their creditors and stockholders, to protect the exclusive jurisdiction of this Court over the Debtors and their assets, and to insure that the provisions of the Bankruptcy Code are carried out. Under the circumstances of this case as set forth in more detail in the Affidavit and the Memorandum of Law in support of the Motion (the "Memorandum of Law") continued prosecution of the Notices of Charges or enforcement of the Temporary Orders would constitute a blatant attempt by the Board to exert direct control over the Debtors' assets, in the face of this Court's exclusive jurisdiction over such assets and in derogation of the rights, claims and interests of the Debtors and their creditors and stockholders. Thus, even in the absence of the automatic stay, an injunction under section 105(a) is clearly warranted.

PENDING JUDGMENT IN THIS ADVERSARY PROCEEDING THE BOARD SHOULD BE ENJOINED FROM PROSECUTING THE NOTICES OF CHARGES AND ENFORCING THE TEMPORARY ORDERS

20. Federal Rule of Civil Procedure 65, made applicable to this adversary procedeing pursuant to Bankruptcy Rules 7001 and 7065, authorizes this Court to issue temporary restraining orders and preliminary injunctions. The requirements for the issuance of a temporary restraining order and preliminary injunction are as follows:

> (1) plaintiff has established a substantial likelihood of success on the merits;
>
> (2) a substantial threat exists that plaintiff will suffer an irreparable injury if the injunction is not granted;
>
> (3) the threatened injury to the plaintiff outweighs the threatened harm that the injunction will cause the defendant; and
>
> (4) the granting of the injunction will not be adverse to the public interest.

21. As set forth in more detail in the Affidavit and the Memorandum of Law, the Debtors submit that there is more than a substantial likelihood that they will succeed on the merits of the Complaint. The Notices of Charges and the Temporary Orders relate to prepetition conduct which is clearly stayed pursuant to section 362 (a) and do not fall within the exceptions enumerated in section 362(b). Furthermore, the Board's administrative actions constitute an imminent threat to the Debtors' assets and reorganization efforts which clearly warrants the issuance of a permanent injunction pursuant to section 105(a).

22. Pending a determination of the Complaint, compliance with the Board's directives and continued prosecu-

tion of the administrative proceedings would cause irreparable injury to the Debtors and their creditors and stockholders for at least two independent reasons. First, preparing for and defending such administrative actions would unduly burden the Debtors' limited economic and human resources. Second, such actions threaten this Court's exclusive authority to administer these chapter 11 cases for the benefit of all of the Debtors' creditors, stockholders and other parties in interest in accordance with the provisions of the Bankruptcy Code.

23. In the absence of a stay of the administrative proceedings commenced pursuant to the March Notice of Charges, the Debtors' management personnel will be forced to direct their attention over the next four weeks almost exclusively to the preparation for the hearing scheduled for May 29, 1989 and to divert their attention from efforts to stabilize and, ultimately, reorganize the Debtors and their businesses. Preparation of a vigorous defense of the March Notice of Charges would require a substantial commitment of time and effort by the Debtors' employees. As described in the Affidavit, the transactions underlying the March administrative charges relating to MBank Dallas and MBank Houston began more than two years ago and the accounting for, and the compiling of information in respect of, such transactions and the offsetting balances will be complex, time-consuming and arduous.

24. The inherent burden of such tasks is, however, increased exponentially in the case of the Debtors. The seizure of the MBanks decimated the Debtors' accounting personnel who were, for the most part, employees of the former MBanks which were seized by the Comptroller and who now work for the DIBB. Thus, the preparation of an effective and vigorous defense to the March Notice of Charges will severely burden the Debtors' few remaining management level employees. Similarly, defending the October Notices of Charges or the Temporary Orders, if the Board seeks to revive them,

will require an equally burdensome commitment of time and effort by such employees. In view of the essentially moot nature of the Board's administrative proceedings, a more wasteful use of the Debtors' limited resources can hardly be imagined.

25. At this critical early stage of these chapter 11 cases, it is absolutely essential to the Debtors' reorganization efforts that their limited resources be focused on the larger and more important goals of stabilizing and rehabilitating the Debtors' remaining businesses. The seizure of the MBanks and their employees required the Debtors' remaining personnel to assume substantially more responsibility for the operations of the Debtors' remaining businesses. Simultaneously, as a consequence of the filing of the chapter 11 cases, the Debtors' personnel has had to focus their immediate attention on compiling and assembling the voluminous information required to be filed at the initial stages of the chapter 11 cases, preparing and filing the typical pleadings necessary to the administration of the chapter 11 cases and responding to and communicating with the United States Trustee, creditors, stockholders and other parties in interest. Unless the Board is enjoined from proceeding, preparing for and defending the Board's administrative actions would unnecessarily divert substantial attention and resources from these activities and derail the Debtors' efforts to develop a business plan and propose a plan or plans of reorganization during the exclusive period.

26. In addition to burdening the Debtors' estates, continued prosecution of the Notices of Charges threatens to disrupt this Court's effective administration of the Debtors' chapter 11 cases. The essence of the May 29 hearing is the determination of a prepetition claim against the Debtors' estates. The determination of such claims against the Debtors' estates is, however, one of the essential functions of this Court and should not be interfered with in any way by any other tribunal. Yet,

even in the face of the Debtors' chapter 11 cases, the Board gives no justification for bringing its administration proceeding. Unless restrained, the Board's actions would frustrate the Court's ability to orderly and consistently administer these estates for the benefit of all of the Debtors' constituents.

27. Further, if the Board is permitted to proceed, it would wrest from *custodia legis* control of the very assets which would form the basis of any plan of reorganization for the Debtors. Through its administrative proceedings, the Board would accomplish this result without the due process protections, including notice and an opportunity to be heard, afforded the Debtors' creditors, stockholders and other parties in interest by the Bankruptcy Code. Under the Notices of Charges, the Board's claims against the Debtors will be determined in a private hearing before an administrative law judge of the Board's own choice. Based upon the administrative law judge's recommendations, the Board will then issue "an appropriate order" and its determination will be subject to review only upon appeal to a circuit court of appeals under the "arbitrary and capricious" standard except in extraordinary circumstances. In view of the Board's past actions detailed in the Affidavit, it is unlikely that the interests of the Debtors' creditors, stockholders and other parties in interest will in any way be protected in such administrative proceedings.

28. The Debtors submit that the foregoing amply demonstrates that the Debtors, their estates and creditors will suffer substantial and irreparable injury and prejudice unless the Board is enjoined from prosecuting the Notices of Charges and enforcing the Temporary Orders pending a resolution of the Complaint.

29. Conversely, there will be no harm or prejudice to the Board if its administative actions are stayed. The Notices of Charges relate principally to former MBanks which are no longer under the control of the Debtors and the Board makes no asertion that the alleged violations

affect the Remaining MBanks. Thus, continued prosecution of the Notices of Charges is largely irrelevant, and serves no regulatory purpose or public interest.

30. As detailed in the Affidavit, the only purpose served by continued prosecution of such administrative actions is to harass the Debtors and protect the pecuniary interests of the FDIC or the DIBB. At the very least, there is no urgency to such proceedings. Indeed, the appropriate procedure for asserting the pecuniary interest of the FDIC or the DIBB is the filing by the FDIC or the DIBB of a proof of claim against the Debtors. Thus, the Debtors submit that any harm to the Board in restraining it from prosecuting its administrative proceedings pales in comparison to the substantial harm to the Debtors and their creditors and stockholders described above. Accordingly, a balancing of the relative harm to the parties clearly favors the issuance of a temporary restraining order and preliminary injunction against the Board.

31. As clearly evidenced by congressional policy, the public interest in this case lies in promoting a successful reorganization of the Debtors. If the Board is permitted to proceed, however, any hope for a successful reorganization will be jeopardized and may even be destroyed at the very outset of the Debtors' chapter 11 cases. The Board's administrative proceedings seek to usurp this Court's control over the Debtors' assets and distribute them in accordance with its own agenda to the detriment of the Debtors' creditors and stockholders whose interests the Bankruptcy Code is intended to protect.

32. Accordingly, the Debtors submit that the facts and circumstances of the instant case clearly warrant the issuance of a temporary restraining order and preliminary injunction restraining and enjoining the Board from prosecuting the Notices of Charges, enforcing the Temporary Orders or initiating any further administrative proceedings against the Debtors without the prior approval of this Court granted after notice to the Debtors and a hearing.

33. No previous application for the relief sought herein has been made to this or to any other Court.

WHEREFORE, the Debtors respectfully request that the Court enter the proposed temporary restraining order, a copy of which is annexed hereto as Exhibit A.

Dated: Houston, Texas
May 2, 1989

By: /s/ D. J. Baker
D. J. BAKER
Attorney-in-Charge
Admission No. 2041
1600 First RepublicBank Center
700 Louisiana
Houston, Texas 77002
(713) 546-5000

Attorneys For MCorp, MCorp Financial, Inc. and MCorp Management, as Debtors and Debtors in Possession

Of Counsel:

ALAN B. MILLER, ESQ.
WEIL, GOTSHAL & MANGES
1600 First RepublicBank Center
700 Louisiana
Houston, Texas 77002
(713) 546-5000

-and-

767 Fifth Avenue
New York, New York 10153
(212) 310-8000

-and-

THOMAS W. LUCE III, ESQ.
HUGHES & LUCE
2800 Momentum Place
1717 Main Street
Dallas, Texas 75201
(214) 959-5500

-and-

JOHN D. HAWKE, JR.
ARNOLD & PORTER
Thurman Arnold Building
1200 New Hampshire Avenue, N.W.
Washington, D.C. 20036
(202) 872-6700

UNITED STATES BANKRUPTCY COURT
SOUTHERN DISTRICT OF TEXAS
HOUSTON DIVISION

Jointly Admin. Chap. 11 Case Nos.
89-02312-H3-11, 89-02324-H5-11, and 89-02848-H2-11
Adversary Proc. No. 89-0298

IN RE: MCORP FINANCIAL, INC, ETC.,
MCORP MANAGEMENT, and MCORP, ETC., DEBTORS.

MCORP, MCORP FINANCIAL, INC., and MCORP MANAGEMENT, DEBTORS IN POSSESSION, PLAINTIFFS

v.

THE BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM OF THE UNITED STATES OF AMERICA, DEFENDANT

[Filed: May 2, 1989]

AFFIDAVIT OF GENE H. BISHOP IN SUPPORT OF EMERGENCY MOTION FOR TEMPORARY RESTRAINING ORDER AND PRELIMINARY INJUNCTION

STATE OF TEXAS)
) ss.:
COUNTY OF DALLAS)

GENE H. BISHOP, being duly sworn, deposes and says:

1. I am the Chairman of the Board and Chief Executive Officer of MCorp and MCorp Management and make this affidavit in support of the emergency motion (the "Motion") of MCorp, MCorp Financial, Inc. ("MCorp Financial") and MCorp Management, debtors in posses-

sion and the above-named plaintiffs (collectively, the "Debtors"), for a temporary restraining order and a preliminary injunction against the Board of Governors of the Federal Reserve System of the United States of America (the "Board"). Except as to those matters stated upon information and belief, I have personal knowledge of the facts set forth herein.

2. Pursuant to the Complaint in the above-captioned adversary proceeding (the "Complaint") and the Motion, the Debtors seeks to restrain and enjoin the Board from prosecuting two separate administrative proceedings initiated by the Board. The first set of administrative proceedings was initiated by the Board in October 1988 and seeks to compel MCorp to infuse all of its available liquid assets into its MBank subsidiaries most of which are no longer under the control of MCorp. The Board's second round of administrative proceedings, initiated in March 1989 after the commencement of MCorp's bankruptcy case, seeks to determine and recover certain alleged prepetition claims against MCorp Management held by the Federal Deposit Insurance Corporation (the "FDIC") as receiver of two of MCorp's former MBank subsidiaries. As set forth below, the Debtors submit that such administrative proceedings are subject to the automatic stay under 11 U.S.C. § 362(a) and, in any event, are moot, largely irrelevant to the Debtors' chapter 11 cases and unduly burdensome and, accordingly, should be stayed.

Commencement of the Chapter 11 Cases

3. On March 21, 1989, three creditors of MCorp commenced an involuntary case under chapter 7 of title 11 of the United States Code (the "Bankruptcy Code") against MCorp (the "Involuntary Petition") in the United States Bankruptcy Court for the Southern District of New York (the "New York Bankruptcy Court"). On March 31, 1989, MCorp Financial and MCorp Management each filed with this Court a voluntary petition

for relief under chapter 11 of the Bankruptcy Code. Later that day, upon application of MCorp, the New York Bankruptcy Court ordered the case commenced by the Involuntary Petition converted to a case under chapter 11 pursuant to section 706(a) of the Bankruptcy Code and entered an order for relief under chapter 11 upon consent of MCorp. Each of the Debtors is operating its business and managing its properties pursuant to sections 1107(a) and 1108 of the Bankruptcy Code.

4. By order dated April 4, 1989, the New York Bankruptcy Court granted MCorp's motion to transfer venue of its chapter 11 case to this Court and, by orders dated March 31, 1989 and April 20, 1989, the chapter 11 cases of MCorp, MCorp Financial and MCorp Management are being jointly administered in accordance with Rule 1015 of the Federal Rules of Bankruptcy Procedure (the "Bankruptcy Rules").

Summary of Relief Requested

5. The filing of the Involuntary Petition and the consequent filing of the voluntary petitions of MCorp Financial and MCorp Management followed a lengthy period during which the FDIC refused to seriously consider a global recapitalization of MCorp and its MBank subsidiaries which MCorp informally proposed to the FDIC in late summer 1988 and formally presented to the FDIC on October 7, 1988 (the "MCorp Assistance Plan"). As detailed below, the Debtors believe that the FDIC's persistent refusal to consider the MCorp Assistance Plan was part of a larger plan of the federal banking regulators to delay FDIC assistance for the MBanks until MCorp contributed all of its liquid assets to the MBanks as additional capital and, then, when a sufficient number of the MBanks were facing liquidity crises or could be made to appear insolvent, the Comptroller of the Currency of the United States of America (the "Comptroller") could seize and transfer their assets to the

FDIC to the detriment of the Debtors' creditors and stockholders.

6. The Board, acting in concert with the Comptroller and the FDIC, played an integral part in this plan. After MCorp refused to downstream its assets to the MBanks except as part of a global recapitalization of the MBanks, in October 1988, the Board initiated administrative proceedings and issued three orders which, taken together, directed MCorp to marshall all of its available assets and transfer them to certain MBanks as capital contributions, without any assurance of FDIC assistance. When MCorp again refused to downstream its assets without the FDIC assistance needed to save the MBanks, the regulators embarked on a campaign of delay that ultimately led to the filing of the Involuntary Petition.

7. Two business days after MCorp learned and notified the regulators of the filing of the Involuntary Petition, on March 28, 1989 the federal regulators carried out their plan and seized twenty of the twenty-five MBanks. Again, the Board played a pivotal role. The Board improperly demanded repayment by MBank Dallas, N.A. ("MBank Dallas") of its substantial borrowings from the Federal Reserve Bank of Dallas. This action had a domino effect rendering at least twelve solvent MBanks allegedly "insolvent."

8. Despite the Debtors' chapter 11 cases, the Board's October administrative proceedings are pending and may be utilized by the Board to obtain leverage over the Debtors in these chapter 11 cases. Indeed, as if to demonstrate its resolve in this regard, within two days after the Comptroller and the FDIC seized the twenty MBanks, the Board initiated another administrative proceeding in March 1989, in essence seeking to recover alleged prepetition claims against the Debtors which are now property of the FDIC, as receiver for two of the seized MBanks. As set forth below, such actions appear calculated only to harass the Debtors.

9. Pursuant to the Complaint, the Debtors seek a permanent injunction to prevent the Board from continuing to prosecute its administrative proceedings. In view of the pendency of the Debtors' chapter 11 cases and the seizure of twenty of the MBanks, such proceedings are moot. Moreover, continued prosecution would further deplete the Debtors' assets, impose substantial burdens on the Debtors and their limited personnel and resources, and otherwise prejudice the legitimate interests of the Debtors' creditors and stockholders, all in contravention of the policies and provisions of the Bankruptcy Code. Specifically, the Complaint seeks a judgment (1)(a) declaring that such administrative proceedings are stayed pursuant to the automatic stay extant under section 362(a) of the Bankruptcy Code or, in the alternative, (b) permanently enjoining the Board from continuing to prosecute such administrative proceedings pursuant to section 105(a) of the Bankruptcy Code, and (2) permanently enjoining and restraining the Board from commencing any further administrative proceedings against the Debtors except with the prior approval of the Court after notice to the Debtors and a hearing. The Motion seeks the entry of a temporary restraining order and preliminary injunction enjoining the Board from taking such actions pending a determination of the Complaint.

Background of the Debtors

10. Prior to the seizure of the MBanks by the federal banking regulators, MCorp and its subsidiaries comprised a banking and financial services enterprise, which, among other things, owned and operated twenty-five MBanks with approximately 85 branch offices serving approximately 33 communities in the State of Texas. As of December 31, 1988, the MCorp banking subsidiaries had combined assets totalling more than $17 billion.

11. MCorp is a holding company principally for MCorp Financial which, in turn, is the holding company for

MCorp Management, the remaining MBanks and substantially all of MCorp's other non-debtor subsidiaries. MCorp Management provides management and technical services for the remaining MBanks and other MCorp subsidiaries.

12. MCorp is a Delaware corporation whose securities are listed and traded on the New York Stock Exchange. As of January 31, 1989, MCorp had outstanding 42,565,012 shares of common stock held by 14,910 stockholders and 959,670 shares of cumulative convertible preferred stock held by 628 holders. In addition, MCorp has outstanding two series of "Money Market Cumulative Preferred Stock" with an aggregate liquidation preference of $125 million that are not publicly traded. MCorp also has outstanding senior and subordinated public debt in the aggregate unpaid principal amount of approximately $470 million, held by 587 holders of record.

Recapitalization Efforts

13. To reverse the effects of the prolonged economic recession of the State of Texas, beginning in the Fall of 1987 MCorp attempted to recapitalize, without federal assistance, through the sale of assets and the issuance of new securities. By the Spring of 1988, however, MCorp's efforts to recapitalize without federal assistance were frustrated. Widespread publicity surrounding the financial difficulties then being experienced by several other major Texas banks led investors to express reservations about recapitalizing MCorp without federal assistance. In view of such investor reaction, MCorp concluded that a private recapitalization plan without federal assistance would not be feasible.

14. As a consequence, MCorp approached the FDIC concerning a federal assistance package. During the Summer of 1988, I and other members of the senior management of the Debtors attempted on numerous occasions to open substantive negotiations with the FDIC on the terms

and conditions of an FDIC assistance package for the MBanks that would include investments by MCorp and third-party investors.

15. L. William Seidman, the Chairman of the FDIC, indicated to me in several meetings his belief that MCorp had done a better job than others in managing the adversities created by the prolonged recession in Texas and was deserving of "help." Seidman further agreed that an early assistance plan would economically benefit the FDIC; however, he did not favor FDIC assistance which could be construed as unduly beneficial to stockholders and creditors of MCorp. Accordingly, the FDIC steadfastly refused to conduct substantive negotiations with MCorp concerning the MCorp Assistance Plan. The FDIC staff explained that the FDIC would not negotiate with MCorp because (a) MCorp was solvent and had several hundred million dollars of liquid assets and (b) the MBanks were neither insolvent nor on the brink of insolvency. Moreover, the FDIC insisted on other conditions to holding negotiations with MCorp, the principal one of which was that MCorp agree either to downstream all holding company funds into chosen banks and/or merge all of the MBanks.

16. In furtherance of its discussions with the FDIC concerning a recapitalization of the MBanks, on October 7, 1988, MCorp requested open bank assistance by formally submitting the MCorp Assistance Plan.

The Board's Regulatory Actions

17. Despite continuous discussions with the Board, the FDIC and the Comptroller in an effort to develop an overall resolution of MCorp's problems, and without any prior notice to MCorp, on October 19, 1988, the Board issued a notice of charges (the "First Notice of Charges") and two temporary cease and desist orders (the "Initial Temporary Orders") against MCorp. Copies of the First Notice of Charges and the Initial Temporary Orders are

annexed hereto as Exhibits A and B, respectively. The First Notice of Charges alleged:

> MCorp and its management have engaged, are engaging, and unless restrained, will continue to engage in unsafe and unsound practices that have weakened and will continue to weaken seriously the condition of MCorp and the Subsidiary Banks and are *likely to cause substantial dissipation of the assets of MCorp that could be used to allow MCorp to serve as a source of financial strength for the Subsidiary Banks.*

First Notice of Charges at ¶ 6 (emphasis supplied). Pursuant to the First Notice of Charges, the Board set a hearing before an administrative law judge of the Board's choice on such charges and a determination of the appropropriate relief.

18. Pending the outcome of the administrative proceedings initiated pursuant to the First Notice of Charges, the Initial Temporary Orders prohibited MCorp, without the consent of the Board, from (a) paying any cash dividends to its stockholders and (b) engaging in any transaction that would have the effect of dissipating MCorp's assets other than (1) interest payments or principal reductions on any outstanding debt that MCorp was obligated to make pursuant to contractual obligations in effect as of October 19, 1988, (2) salaries or (3) payments for goods and services that MCorp was obligated to make pursuant to contractual obligations in effect as of October 19, 1988.

19. The allegations set forth in the First Notice of Charges were without any factual basis. MCorp had taken no action which would lead the Board to believe that it intended to dissipate its assets. Indeed, MCorp had made substantial efforts to preserve its assets for infusion into the MBanks in accordance with the MCorp Assistance Plan. For example, on October 24, 1988, MCorp publicly announced a moratorium, effective as of

October 21, 1988, on the payment of all principal of and interest on all of its approximately $470 million of senior and subordinated debt obligations despite the fact that neither the Initial Temporary Orders nor the First Notice of Charges required MCorp to take such actions. By these actions, MCorp sought to preserve its assets for use in connection with a global recapitalization and assistance plan. The Board at all times knew of MCorp's willingness to dedicate its resources to implement a comprehensive recapitalization plan consistent with the interests of its creditors, stockholders and other constituencies.

20. Although MCorp was in full compliance with the Initial Temporary Orders, late in the afternoon of October 26, 1988 (and again without any prior indication to MCorp), the Board issued an "amended" notice of charges (the "Amended Notice of Charges") and a third temporary cease and desist order (the "Third Temporary Order") against MCorp. Copies of the Amended Notice of Charges and the Third Temporary Order are annexed hereto as Exhibits C and D, respectively.[1] The Amended Notice of Charges reiterated the allegations of the First Notice of Charges, but expanded the relief sought. In particular, pursuant to the Amended Notice of Charges, the Board sought a permanent cease and desist order directing MCorp, among other things, to prepare and implement "an acceptable capital plan that would ensure that all of MCorp's available assets are used to recapitalize the [MBanks] that are suffering capital deficiencies." Amended Notice of Charges at ¶ 9(d).

21. In the interim, the Third Temporary Order required MCorp to "take such actions as are necessary to use all of its assets to provide capital support to [MBanks] in need of additional capital" and to report to

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[1] The First Notice of Charges and the Amended Notice of Charges are sometimes referred to herein collectively as the "October Notices of Charges". The Initial Temporary Orders and the Third Temporary Order are sometimes referred to herein collectively as the "Temporary Orders".

the Board, within 15 days of October 26, 1988, the identity of each MBank into which capital would be infused and the amount of capital to be infused into each such MBank. Third Temporary Order at ¶ 1.

22. The issuance of the Amended Notice of Charges and the Third Temporary Order were coordinated with the issuance on October 27, 1988 by the Comptroller of notices of intent to issue capital directives against eighteen MBanks. Such notices of intent advised the relevant MBanks that the Comptroller intended to issue directives to each such MBank requiring it, among other things, to achieve a minimum level of primary capital.

23. Upon information and belief, the basis for the October Notices of Charges and the Temporary Orders was the Board's self-promulgated and, as yet, untested "source of strength" doctrine. MCorp's attorneys advised me that the "source of strength" doctrine has no basis in law and had no application to the Debtors' then existing circumstances.

24. MCorp's attorneys also advised me that if MCorp complied with the Third Temporary Order and downstreamed its assets to the MBanks without FDIC assistance for such banks, such action would have exposed MCorp and its officers and directors to claims by creditors and stockholders of fraudulent conveyances, corporate waste and mismanagement. At the time that the October Notices of Charges and the Temporary Orders were issued, MCorp had available financial resources of only approximately $250 million to contribute to MBanks that were in need of additional capital and financial assistance in an amount substantially in excess of MCorp's available resources. Obviously, infusion of such limited capital into the MBanks without additional FDIC assistance would have been futile. Indeed, by letter dated October 25, 1988, (the "Shearson Letter"), Shearson Lehman Hutton, one of MCorp's largest creditors and stockholders, expressed to the Board of Directors of MCorp its firm conviction that such a "stopgap" measure would violate

MCorp's fiduciary obligations to its creditors and stockholders. A copy of the Shearson Letter is annexed hereto as Exhibit E. Moreover, on November 9, 1988, Charlifco and Charter National Life Insurance Company filed suit against MCorp in Delaware Chancery Court seeking the issuance of an injunction prohibiting MCorp from taking such actions on the ground that such actions would constitute a fraudulent conveyance under Texas law. A copy of the Charlifco complaint is annexed hereto as Exhibit F. Other creditors and stockholders of MCorp also threatened similar or more drastic actions. Although MCorp advised the federal regulators of such concerns, the FDIC had given MCorp no assurances that if MCorp infused capital into the MBanks before negotiating a recapitalization plan, the FDIC would even consider the interests of MCorp's other constituencies in developing a recapitalization plan.

25. On October 3, 1988, MCorp filed a First Amended Complaint and Application for Injunction (the "Complaint") against the Board in the United States District Court for the Northern District of Texas, Dallas Division, seeking preliminary and permanent injunctive relief suspending or setting aside the Temporary Orders on the grounds that the Temporary Orders (a) were invalid and without basis in law or fact, (b) damaged the prospects for an FDIC assisted recapitalization plan for the MBanks and undermined public confidence in MCorp and the MBanks, and (c) required MCorp to violate its fiduciary, statutory and contractual duties to its stockholders and creditors. A copy of the Amended Complaint is annexed hereto as Exhibit G.

The Standstill Agreement

26. After extended negotiations, over the weekend of November 5, 1988, MCorp and all of the federal regulators reached a standstill agreement relating to the October Notices of Charges and the Temporary Orders, the

terms of which were embodied in a letter agreement between MCorp and the FDIC dated November 6, 1988 (the "Standstill Agreement"). A copy of the Standstill Agreement is annexed hereto as Exhibit H. In the Standstill Agreement, the FDIC committed to "commence negotiations on [MCorp's] proposal *at once*", while soliciting proposals from third parties. In fact, the Standstill Agreement contemplated a ten-week bidding period and a decision by the FDIC concerning all proposals within two weeks thereafter (*i.e.*, approximately January 31, 1989). For its part, MCorp agreed to use all reasonable efforts to maintain stability in the MBanks, prevent the commencement of a voluntary or involuntary bankruptcy case, and assure the continuation of traditional interbank relationships, in particular interbank funding, among its subsidiary banks, and to cooperate with the FDIC in the bidding process.

27. In conjunction with the Standstill Agreement, by letter dated November 7, 1988 (the "Standstill Letter"), the Board agreed to (a) defer the time for submission of the report of capital injections into the MBanks required by the Third Temporary Order until five days following notice to MCorp from the Board, (b) postpone the administrative and any judicial proceedings relating to the October Notices of Charges and the Third Temporary Order for thirty days from their scheduled dates, and (c) extend the time to file an answer to the October Notices of Charges to November 11, 1988. A copy of the Standstill Letter is annexed hereto as Exhibit I.

The Regulators' "Negotiations" with MCorp

28. Over the course of the next ten weeks and, indeed, at least through the date of the seizure of the MBanks, MCorp cooperated with the federal regulators and fulfilled all of its obligations on a timely basis under the Standstill Agreement. In stark contrast to MCorp's efforts to comply with the Standstill Agreement, and de-

spite the FDIC's written commitment to negotiate with MCorp and Chairman Seidman's assurances to MCorp immediately prior to November 6, 1988, the FDIC never negotiated a recapitalization plan or an assistance program for the MBanks with MCorp.

29. Indeed, in hindsight, it appears to me that the FDIC never really considered an open bank assistance plan for the MBanks, at least after MCorp refused to comply with the regulators' demands that MCorp downstream its assets or otherwise place its assets at risk to subsequent actions by the regulators as a condition to such assistance. Rather, the efforts of the FDIC, acting in concern with the Comptroller and the Board, were singularly directed first toward depriving MCorp of its liquid assets and then delaying any federal assistance while the MBanks lost hundreds of millions of dollars of franchise value to enable the FDIC to implement a "closed bank" scenario. A closed bank scenario would entail the Comptroller declaring the MBanks insolvent, closing them and transferring their assets to a "bridge bank" for liquidation or sale to a third party, all without regard for the legitimate interests in such MBanks of the Debtors' creditors and stockholders.

The Seizure of the MBanks

30. The "hidden agenda" of the federal regulators was implemented after the close of business on March 28, 1989 and before the opening of business on March 29, 1989. In the evening of March 28, without any prior notice, scores of representatives of the Comptroller and the FDIC moved into all twenty-five MBanks. Upon entering the MBanks, the Comptroller immediately closed the seven or eight insolvent MBanks and transferred their assets to the FDIC as receiver. Throughout the night and the next morning, the federal regulators, through a concerted and methodical effort, manufactured the insolvency of at least twelve of the remaining, but previously solvent, MBanks.

31. The Board, at the behest of the FDIC and the Comptroller, demanded without explanation repayment of MBank Dallas' borrowings from the "discount window" at the Federal Reserve Bank of Dallas. This demand was made at a time when MBank Dallas was not in default, had qualifying assets sufficient to collateralize existing borrowings and, in fact, had additional borrowing capacity in excess of $300 million. The Board's act immediately rendered MBank Dallas, which previously had in excess of $50 million of regulatory capital, insolvent.

32. After the Comptroller seized MBank Dallas, all but five of the remaining solvent MBanks were then made to appear insolvent by the wrongful refusal of the FDIC acting as receiver for MBank Dallas to recognize the interbank funding liabilities of MBank Dallas to the solvent MBanks. These were the very same interbank funding obligations that MCorp, at the urging of the FDIC and the Comptroller, was required to use its reasonable efforts to assure were maintained in order to comply with the Standstill Agreement. Yet, by unilaterally determining that such deposits had suffered an impairment of value, the Comptroller, working hand in glove with the FDIC, declared the solvent MBanks insolvent. Indeed, the Comptroller and the FDIC vaguely conceded the means by which they manufactured insolvency in a joint press release dated March 29, 1989, a copy of which is annexed hereto as Exhibit J, in which they admitted that "the bulk of the banks became insolvent due to a combination of loan losses and *Losses from intercompany transactions.*"

33. The treatment by the federal regulators of the interbank funding arrangements between MBank Dallas and the other MBanks contrasts sharply with the treatment of interbank accounts between MBank Dallas and other banks. While the Comptroller and the FDIC forced the MBanks to take significant losses on the interbank accounts, the claims of other banks and depositors were

paid in full. If, however, the interbank accounts of the MBanks were, as the treatment by the Comptroller and the FDIC suggests, unsafe or unsound, the Comptroller should have forced the MBanks to clarify or write down such amounts in conjunction with its previously completed examinations of the MBanks. In such examinations, although the Comptroller forced the MBanks to write off hundreds of millions of dollars of loans, none of such writeoffs involved the MBanks' funding arrangements with MBank Dallas and MBank Houston, N.A. ("MBank Houston").

34. Thereafter, the FDIC obtained *ex parte* orders from the United States District Courts in all four Texas districts approving the transfer of certain deposits and other liabilities, and certain assets of the receivership estates of the twenty MBanks to The Deposit Insurance Bridge Bank, National Association (the "DIBB"), a newly created entity wholly owned by the FDIC.

35. The actions by the federal regulators on March 28 and 29 left MCorp with only five MBanks (the "Remaining MBanks"), with a net book value as of December 31, 1988 of approximately $125 million.

36. MCorp's attorneys have advised me that the actions of the federal regulators on March 28 and 29 not only violate every fundamental precept of good faith and fair dealing, but that such actions were beyond the statutory authority of the Comptroller and the FDIC. Accordingly, MCorp has filed an action against the Comptroller and the FDIC in the United States District Court for the Northern District of Texas, Dallas Division, asserting that the FDIC and the Comptroller, in seizing twelve or more solvent MBanks, exceed their statutory authority and wrongfully deprived MCorp of its property without just compensation. A copy of the Amended Complaint is annexed hereto as Exhibit K. Pursuant to the Amended Complaint, MCorp seeks injunctive relief and damages in excess of $70 million.

The March Notice of Charges and the MNet Transaction

37. Within one day after the Comptroller seized the twenty MBanks, the Board commenced a new round of administrative proceedings against MCorp and MCorp Management by issuing a notice of charges dated March 30, 1989 (the "March Notice of Charges"). A copy of the March Notice of Charges is annexed hereto as Exhibit L. The March Notice of Charges alleges that MCorp and MCorp Management have engaged, are engaging and, unless restrained, *will continue* to engage in violations of section 23A of the Federal Reserve Act, 12 U.S.C. § 371c, in that MCorp and MCorp Management allegedly caused MBank Houston and MBank Dallas, two of the MBanks seized by the Comptroller and transferred to the DIBB, to extend to MCorp Management "unsecured extensions of credit." March Notice of Charges at ¶ 5. The March Notice of Charges further alleges that MCorp and MCorp Management

> have engaged, are engaging and, unless restrained, *will continue* to engage in unsafe and unsound practices in that (a) MCorp and MCorp Management have failed to cause MBank Dallas and MBank Houston to record or report properly on their books and financial statements the amounts due from MCorp Management on the unsecured extensions of credit . . ., (b) MCorp Management has not properly recorded or reported on its books and financial statements the unsecured extensions of credit from these two Subsidiary Banks, and (c) MCorp Management had failed to account properly for the arrearages totalling over $14 million that are due to MBank Dallas and MBank Houston and has failed to record or report such arrearages on its books and financial statements.

March Notice of Charges at ¶ 6. The March Notice of Charges sets May 29, 1989 as the date on which an administrative law judge designated by the Board will conduct a hearing to take evidence and determine whether an appropriate order should be issued. March Notice of Charges at ¶ 9.

38. Like the October Notices of Charges, the March Notice of Charges simply has no factual basis. The alleged "unsecured extensions of credit" and "unsafe and unsound practices" in the March Notice of Charges relate to a transaction—the "MNet Transaction"—which occurred more than two years ago. The MNet Transaction has its origins in transactions which formed part of the reorganization of MCorp's credit card operations.

39. Specifically, on August 1, 1985, MBank Houston and MBank Preston, N.A. ("MBank Preston"), which subsequently was merged into MBank Dallas, sold certain assets of their credit card operations to MBank USA, a wholly owned subsidiary of MNet Corp ("MNet"), itself a wholly owned subsidiary of MCorp Financial. In connection with such sale, and to fund the ongoing operations of MBank USA, MBank Houston and MBank Preston sold federal funds on August 1, 1985 in the approximate aggregate amount of $364 million to MBank USA "until further notice", pursuant to letter agreements dated August 1, 1985 and October 9, 1985 (collectively, the "Letter Agreements"). Banks routinely buy and sell federal funds. In an "until further notice" federal funds transaction, the selling bank typically agrees to transfer to the buying bank a specified amount of federal funds and, in exchange, the buying bank agrees to pay the selling bank interest at a Federal Funds rate and to retransfer the federal funds upon demand.

40. In exchange for the use of MBank Houston's and MBank Preston's federal funds, MBank USA agreed to (a) repay the principal amount of and interest due on such federal funds upon receipt of demand and (b) pay as "Additional Contingent Fees" the lesser of a fixed sum or a sum equal to a percentage of MBank USA's monthly net income until the earlier of (i) payment of a specified

amount to each particular bank or (ii) December 31, 1993. Copies of the Letter Agreements are annexed hereto as Exhibits M and N. According to the terms of the Letter Agreements, MBank USA's obligation to pay Additional Contingent Fees survived the termination of the sale of federal funds and the repayment of principal and interest relating thereto.

41. In the MNet Transaction, MCorp Financial sold the capital stock of MNet to Lomas & Nettleton Financial Corporation ("L&N") in exchange for cash, promissory notes issued by L&N (the "L&N Notes"), Series B Preferred Stock of L&N (the "L&N Preferred Stock") and common stock of L&N, all pursuant to a Stock Purchase Agreement dated as of November 16, 1986. In connection with such sale, MBank Houston and MBank Preston agreed to (a) terminate their respective federal funds transactions with MBank USA and (b) release MBank USA from its obligations to pay the Additional Contingent Fees. In consideration therefor, MBank Houston and MBank Preston requested a substitute arrangement to compensate them for the Additional Contingent Fees from MBank USA to which they originally were entitled.

42. To facilitate the sale of MNet to L&N, MCorp Management agreed to provide such substitute contingent payment arrangement by paying MBank Houston and MBank Preston an aggregate amount equal to the lesser of (a) the sum of the interest actually received by MCorp Management on the L&N Notes and the dividends actually received by MCorp Management on the L&N Preferred Stock or (b) quarterly cash payments aggregating $2,853,000 (the "Contingent Payments"). Copies of the Agreements embodying such arrangements are annexed hereto as Exhibits O and P. Like MBank USA's obligation to pay the Additional Contingent Fees for which the Contingent Payments were intended as a substitute, MCorp Management's obligation to make the Contingent Payments terminated on the earlier of payment in full of

the amount of Additional Contingent Fees then due or December 31, 1993.

43. The March Notice of Charges characterizes MCorp Management's obligation to make the Contingent Payments either as "unsecured extensions of credit" (March Notice of Charges at ¶ 5(b)(1)) by MBank Dallas and MBank Houston to MCorp Management or as repayment of "unsecured extensions of credit" (March Notice of Charges at ¶ 5(a)(1)). I have been advised by MCorp's attorneys that there is no basis in law or fact to characterize the Contingent Payments as "extensions of credit". The Contingent Payments cannot be considered an "extension of credit" because no funds or other properties of MBank Houston and MBank Preston were ever received by MCorp Management in exchange or consideration for the Contingent Payments. The Contingent Payments merely represent an override on revenues that MCorp Management may or may not receive as interest and dividends on the L&N Notes and L&N Preferred Stock, with a defined maximum amount of $2,583,000 quarterly.

44. Moreover, MCorp Management is not in arrears on any obligation it may have to the FDIC, in its capacity as receiver of MBank Dallas and MBank Preston, or to the DIBB, as transferee from the receivership estates of MBank Dallas and MBank Houston of any such alleged claims against MCorp Management because MCorp Management has made substantial payments for and on behalf of MBank Dallas and MBank Houston which as of March 31, 1989 more than offset the amounts allegedly owing to such banks at that time.

45. Accordingly, on April 19, 1989, MCorp and MCorp Management filed an Answer to the March Notice of Charges challenging the authority of the Board to bring such action and denying the legal and factual bases of the March Notice of Charges. A copy of the Answer is annexed hereto as Exhibit Q. In such Answer, MCorp and MCorp Management expressly reserved the right to bring this action.

Reasons for Relief

46. I believe that compliance with the Board's directives and continued prosecution of the administrative proceedings would seriously prejudice the Debtors and the rights and interests of their creditors and stockholders. The October Notices of Charges and the Temporary Orders seek to force MCorp to downstream substantially all of its liquid assets into the MBanks. In view of the pendency of the chapter 11 cases and the seizure of the MBanks, the October administrative proceedings are patently moot. Such proceedings, on their face, apply to all twenty-five MBanks, twenty of which are no longer under the direct or indirect control of MCorp. Moreover, the remaining five MBanks are solvent. Despite their efforts on March 28 and 29, the federal regulators were unable to manufacture their insolvency.

47. To the extent that the October Notices of Charges and Temporary Orders attempt to prohibit MCorp from dissipating its assets, such proceedings are completely unnecessary and MCorp's attorneys advise me that continued prosecution of such proceedings would constitute an affront to this Court's exclusive jurisdiction over the Debtors' property. Not only does MCorp have no intention of dissipating its assets, but, as MCorp's attorneys advise me, the Bankruptcy Code prohibits the use, sale or lease outside of the ordinary course of business of *any* of the Debtors' property without this Court's prior approval. Such control over the Debtors' assets serves to insure an appropriate balance of the respective rights and interests of all of the Debtors' creditors, stockholders and other parties in interest, including the federal regulators. If, however, the Board is permitted to proceed on the October Notices of Charges or institute other administrative proceedings based on the "source of strength" doctrine, there exists a substantial risk that the assets of the Debtors' estates will be depleted without affording the Debtors' creditors and stockholders an opportunity to be heard or the Debtors an opportunity to reorganize. On

the other hand, there will be little or no prejudice to the legitimate interests of the Board if the relief requested is granted. Just like other parties in interest in the Debtors' chapter 11 cases, the Board may appear and be heard in any matter in which it has an interest.

48. Similarly, continued prosecution of the March Notice of Charges is pointless in view of the pendency of the Debtors' chapter 11 cases. As noted above, the Board's administrative proceedings commenced in March seek a determination that the Contingent Payments are "extensions of credit" and that MCorp Management owes money to the FDIC, as receiver for MBank Houston and MBank Dallas, or to the DIBB, as transferee of the assets of the receivership estates of MBank Houston and MBank Dallas. The Board's March Notice of Charges issued under the guise of enforcement and regulatory action is without legal or factual merit and I believe is intended to harass the Debtors and to improve the position of the FDIC.

49. The Debtors vigorously dispute the Board's characterization of the transactions as "extensions of credit" and deny that any payments were due to MBank Houston and MBank Dallas arising out of MCorp Management's Contingent Payment obligations. In fact, MCorp Management has made a number of cash payments on behalf of or otherwise provided direct financial support to such MBanks which exceed the maximum amount of the outstanding Contingent Payments allegedly owing. Moreover, regardless of the merits of these assertions, the March administrative proceeding mirrors a typical commercial dispute. If the Board is permitted to proceed on the March Notice of Charges, MCorp's attorneys advise me that one effect of its actions would be an adjudication of the validity of a prepetition claim of the FDIC and a prepetition setoff against those claims. I believe that this dispute should, like any other dispute with a chapter 11 debtor, be heard in this Court in accordance with the procedures and protections contemplated by section 502

of the Bankruptcy Code and the pertinent Bankruptcy Rules.

50. Unless the Board is enjoined from exercising its purported enforcement powers against the Debtors and their assets, I believe their actions will substantially and irreparably harm the Debtors' estates, their creditors and stockholders. If the Board is permitted to continue to prosecute its administrative proceedings, the Debtors will be forced to commit substantial resources to preparing for and defending the charges relating to a prepetition claim at a time when the Debtors' limited economic and personnel resources can be put to more effective uses. Dedicating personnel and economic resources would have a devastating effect on the administration of the Debtors' estates and could cripple the Debtors' efforts to successfully reorganize.

51. Simply put, at this critical time, the Debtors need to direct all of their limited resources to the stabilization of their businesses and the implementation of the chapter 11 process. The Debtors do not have sufficient personnel and economic resources to commit to prepare for and defend a typical commercial dispute for which the proper course of action is to file a proof of claim.

52. The Debtors have only approximately twenty-seven employees. In addition to myself, such employees include the President and Chief Operating Officer and the Group Chairman—Chief Financial Officer. Of the remaining employees, approximately five have general responsibility for the financial and business affairs of the Debtors and their non-debtor subsidiaries. Prior to the seizure of the MBanks, MBank employees provided the bulk of the technical services to the MCorp enterprise, including other MBanks.

53. Since the receivership of the twenty MBanks, the few remaining MCorp employees have had to assume considerably more responsibility for the supervision of the five Remaining MBanks and the Debtors' other banking and non-banking subsidiaries. Specifically, the Debtors'

employees have had to assume responsibility for accounting, financial reporting and compliance with banking regulations previously delegated to the former MBank employees.

54. In addition ot the responsibilities relating to the MBanks, the pendency of the Debtors' chapter 11 cases has also imposed substantial new obligations on the Debtors' employees. Since the filing of the chapter 11 cases, the Debtors' employees have had to devote substantial time and effort in compiling and assembling the various information required to complete the required reports, statements and schedules relating to the commencement of a bankruptcy case. The Debtors' personnel have also been involved in various meetings with the United States Trustee and constant communication with the Debtors' attorneys.

55. Moreover, the Debtors' chapter 11 cases will necessitate an even greater commitment of time and attention of the Debtors' employees. The Debtors' attorneys have advised me that most likely there will be numerous hearings and matters relating to the overall administration of a chapter 11 case in addition to a substantial amount of litigation. Preparing for and prosecuting or defending such litigation will impose a substantial, additional drain on the limited management time and attention. Following the initial stabilization, the Debtors' attention will necessarily turn to the development of a business plan for the Debtors. The creation of a business plan obviously will require the attention of MCorp management at all levels, along with coordination with the Debtors' attorneys, accountants, investment bankers and others. Once that plan is in place, the efforts of all parties in interest in the Debtors' chapter 11 cases will turn to the development of a plan or plans of reorganization. Of necessity, the development and negotiation of a plan will require an enormous commitment of time of the Debtors' employees communicating with the Debtors' creditors, stockholders and other constituents, particularly in view of the unusual nature of these chapter 11 cases and the number

of parties in interest who undoubtedly will have counsel and maybe even investment bankers.

56. In view of the Debtors' limited resources, continued prosecution of the Board's administrative proceedings would divert critical management time and attention from the larger issues facing the Debtors. Such actions could frustrate the Debtors' chances for a successful reorganization at this early stage of their chapter 11 cases and maybe even destroy any hope for a successful reorganization. The Debtors' valuable attention and limited professional resources should be employed for the more important goals of rehabilitating the Debtors and preserving the Debtors' assets for the benefit of all creditors and stockholders.

57. Accordingly, I believe that it is imperative that the Court enter a temporary restraining order and a preliminary injunction (1) restraining and enjoining the Board from prosecuting its administrative proceedings and enforcing the Temporary Orders and (2) restraining and enjoining the Board from commencing any further administrative proceedings or actions to obtain or enforce a cease and desist order or other relief against any of the Debtors or any property of the Debtors' estates without the prior approval of this Court after notice and a hearing.

58. No previous application for the relief requested herein has been made to this or any other Court.

/s/ Gene H. Bishop
GENE H. BISHOP

Subscribed and sworn to this
1st day of May 1989 —

/s/ Ann E. Meek
ANN E. MEEK
Notary Public State of Texas
My Commission expires 2/25/92

[Certificate of Service Omitted in Printing]

Jeffrey B. Lane
President and
Chief Operating Officer

SHEARSON
LEHMAN
HUTTON
An American Express Company

October 25, 1988

The Board of Directors
MCorp
P.O. Box 655415
Dallas, Texas 75265-5415

Gentlemen:

We are the holder of $29,000,000 of MCorp's Floating Rate Subordinated Capital Notes Due 1997, and 235 shares of MCorp's Money Market Cumulative Preferred Stock (with an aggregate liquidation preference of $117.5 million). We are writing as a result of recent developments affecting MCorp and MCorp's announcement yesterday that its Board of Directors has determined that MCorp is not at present in a position to make payments of interest or principal when due on MCorp's long-term debt, or to pay dividends on any class of MCorp stock.

We wrote to you on August 24, 1988 to express our concern that the financial condition of MCorp's major bank subsidiaries is precarious and deteriorating, that even with an infusion of all of MCorp's available funds there would be no reasonable prospect of returning these bank subsidiaries to profitability, and that it would therefore be wholly inconsistent with the Board's duty to MCorp's creditors and stockholders to make any further investment in or extension of credit to these subsidiaries. Events since August 24, including MCorp's October 7 request for FDIC assistance, its October 7 announcement of an estimated consolidated third quarter loss of $525 million, and yesterday's announcement of a payment moratorium, have confirmed that any further MCorp in-

vestment in or credit extension to these bank subsidiaries would be wasteful and wrong. The Board's duty now is to preserve MCorp's value by all means necessary, and we believe the means considered should include the immediate filing of a voluntary petition under Chapter 11 of the Bankruptcy Code.

On October 7, MCorp announced that it is seeking substantial "open bank" assistance from the FDIC in connection with a proposed recapitalization of the holding company and its subsidiary banks. We publicly stated our support for that effort. We continue to support, strongly, the Board's determination that MCorp's lead banks can be saved only by a recapitalization, involving the FDIC and all other parties now at risk, at a level adequate to place them in a sound financial condition and return them to profitability.

Yesterday's announcement acknowledges that, although the parent company has significant nonbank assets, and although several of its bank subsidiaries have positive values, MCorp is unable under all the circumstances to continue making payments on its long-term debt. It also reflects MCorp's determination to stop the flow of assets out of the parent company and its healthy subsidiaries until there can be either an adequate recapitalization, in which all interests are fairly treated and appropriately protected, or a decision that the deteriorating banks will be disposed of.

The decision to stop the payment of cash to creditors and stockholders heightens the Board's obligation to take whatever other measures are necessary to avoid wasting the significant assets that now stand behind MCorp's obligations to its security holders. In particular, it now would be even more obviously improper for the Board to allow MCorp to risk its own assets, or those of its nonbank or healthy bank subsidiaries, on stopgap measures that will only prolong the deterioration of the troubled bank subsidiaries. MCorp has acknowledged that an FDIC-assisted recapitalization is necessary to return the

troubled banks to profitability. No further investment in, extension of credit to, or guarantee of the obligations of, any of the troubled banks would be justified except simultaneously with (not prior to) and as an integral part of such recapitalization on terms that are fair to creditors and stockholders.

The Board should use all means necessary to resist wastefully depleting MCorp's assets and bargaining power before the needed recapitalization has been negotiated. Specifically, we understand that the Board has considered the advisability and consequences of voluntarily placing MCorp into proceedings under Chapter 11 and has referred to this option as a part of its assistance proposal to the FDIC. We believe that the Board's acknowledgment of MCorp's present inability to pay its long-term debt and its need for an overall recapitalization make such an action appropriate, and we would support such an action at this time as a means of protecting MCorp's present value.

For our part, we are prepared to work with you, other creditors and stockholders, new investors, and the FDIC toward recapitalization that fairly and adequately resolves MCorp's problems. We are not prepared, however, to see our substantial investment in MCorp lose its value because of imprudent stopgap support (in any form) that will not restore the troubled banks to profitability but will only deplete MCorp's assets and imperil its now healthy bank and nonbank subsidiaries. We would resist any such course by all necessary steps, including steps to place MCorp in Chapter 11 should that become necessary and should the Board be unwilling to do so.

We would of course be pleased to discuss this matter with the appropriate representatives of MCorp at any time.

Sincerely,

/s/ Jeffrey B. Lane
JEFFREY B. LANE
President

IN THE COURT OF CHANCERY
OF THE STATE OF DELAWARE
IN AND FOR NEW CASTLE COUNTY

C.A. No. 10426

CHARLIFCO, a Missouri general partnership, and
CHARTER NATIONAL LIFE INSURANCE COMPANY,
a Missouri corporation, PLAINTIFFS

v.

MCORP, a Delaware Corporation, DEFENDANT

[Filed: Nov. 9, 1988]

COMPLAINT

For this complaint, plaintiffs Charlifco and Charter National Life Insurance Company ("Charter") allege as follows:

1. Charlifco is a Missouri general partnership and is a nominee partnership used to effect investments solely for Charter. Charter is a corporation organized and existing under the laws of the State of Missouri.

2. Defendant MCorp is a corporation organized and existing under the laws of Delaware, with its principal place of business in Dallas, Texas.

3. Charter is a life insurance company and receives insurance premiums from its policyholders. The proceeds of these premiums are invested in long-term investments

in accordance with Missouri law and regulations established by the Commissioner of Insurance for Missouri. Charter makes such investments primarily through Charlifco.

4. Like other insurance organizations, Charter provides substantial amounts of long-term capital to the banking industry, primarily through the purchase of debt securities issued by bank holding companies. These securities are generally purchased for the purpose of long-term investment and not for short-term speculation.

5. Charter, through Charlifco, purchased $6,725,000 principal amount of certain 11.504 Debenture Notes issued by Mercantile Texas Corporation, which subsequently changed its name to MCorp (the "Debenture Notes"), which Debenture Notes mature on December 15, 1989. Charlifco is and was at all relevant times the holder of record of the Debenture Notes.

6. MCorp is a bank holding company which owns the capital stock of 26 banks (the "MCorp Banks").

7. The MCorp Banks, on a consolidated basis, are insolvent as defined in the fraudulent conveyance statutes of both the State of Texas and the State of Delaware ("insolvent"). 4 *Tex. Bus. & Com.* Code Ann. Chapt. 24 *and* 6 *Del. C.* Chapt 13 (the "Fraudulent Conveyance Statutes").

8. For the year ended December 31, 1986, MCorp lost $301,000,000 (after excluding two one-time extraordinary non-recurring gains).

9. For the year ended December 31, 1987, MCorp lost $258,300,000.

10. During the past ten months, the financial condition of MCorp has deteriorated even more dramatically, having lost $62,400,000 for the quarter ending March 31, 1988, $169,300,000 (after excluding a one-time extraordinary non-recurring gain) for the quarter ending June 30, 1988, and $517,000,000 for the quarter ending September 30, 1988. Thus, through September 30, 1988,

MCorp has lost $748,700,000, and since 1986, more than $1,300,000,000.

11. Between year end 1986 and 1987, MCorp's assets declined by $1,700,000.00.

12. Between June 30, 1987 and June 30, 1988 (the last period for which financials are publicly available), MCorp's assets declined in excess of $2,000,000,000.

13. All of the losses which MCorp has suffered over the past three years are directly attributable to the MCorp Banks.

14. During the past three years, MCorp has been liquidating all of the substantial assets owned directly by it.

15. On December 30, 1986, MCorp sold its subsidiary MNet Corp. for $300,000,000.

16. On April 19, 1988, MCorp said its 804 interest in MTech Corp., the leading financial data processing company in the United States, for $292,000,000.

17. On information and belief, MCorp has retained at the parent level more than $400,000,000 of the cash and marketable securities which it received from the sale of its assets.

18. On information and belief, the MCorp Banks require an investment in excess of $1,000,000,000 in order not to be insolvent on a consolidated basis.

19. On October 7, 1988, MCorp filed with the Federal Deposit Insurance Corporation (the "FDIC") a request for assistance. On information and belief, MCorp proposed to the FDIC a recapitalization plan for the MCorp Banks requiring FDIC assistance in an amount in excess of $1,000,000,000, new equity investments in the amount of $400,000,000 in cash and marketable securities raised from the sale of the parent company's assets, without any consideration being received by MCorp therefor.

20. On information and belief, the FDIC refused to consider MCorp's proposal unless MCorp contribute to the MCorp Banks $400,000,000 in cash and marketable securities prior to the FDIC committing to any recapitalization plan for the MCorp Banks.

21. On or about October 20, 1988, the FDIC began pressuring MCorp to immediately contribute to the MCorp Banks $400,000,000 in cash and marketable securities by having the Federal Reserve Board issue a temporary order preventing MCorp from declaring dividends on its common and preferred stock and from engaging in the dissipation of assets of MCorp without the prior apppoval of the Federal Reserve Board. If the preferred shareholders' dividends are not paid by November 21, 1988, MCorp will be in default and could be forced into bankruptcy.

22. On October 21, 1988, MCorp failed to make a payment of interest due on certain notes which it had issued. If the payment of interest is not made by November 21, 1990, MCorp will be in default and could be forced into bankruptcy.

22. On October 24, 1988, MCorp announced that it had lost $127,000,000 during the third quarter of 1988 and that it was suspending payment of all preferred stock dividends and all principal and interest on all of its public and privately placed indebtedness, including the Debenture Notes.

24. Also, on October 24, 1988, MCorp announced that it intended to use the monies due its creditors, together with all of its other assets, to recapitalize the MCorp Banks.

25. On or about October 28, 1988, MCorp announced that it expected to be in bankruptcy by November 20, 1988. If MCorp does not meet its dividend payment deadline of November 20, 1988, it will be in default and could be forced into bankruptcy.

26. During the last few days of October, the FDIC continued to pressure MCorp by having the Comptroller of the Currency notify eighteen of the MCorp Banks that it intends to demand that they raise more capital and by having the Federal Reserve Board order MCorp to draft a plan to boost the MCorp Banks' capital. All of this is designed to force MCorp to contribute $400,-

000,000 in cash and marketable securities to the MCorp Banks.

27. On information and belief, MCorp intends to transfer in cash and marketable securities to the MCorp Banks without receiving reasonable equivalent value and fair consideration as respectively defined in the Texas and Delaware Fraudulent Conveyance Statutes ("reasonable equivalent value" and "fair consideration"). On information and belief, MCorp intends to make one such transfer prior to November 20, 1988 in the amount of approximately $400,000,000.

COUNT I
(Fraudulent Transfer)

28. Plaintiffs repeat and reallege each of the allegations contained in paragraphs 1 through 28 of this complaint.

29. MCorp either is insolvent or will become insolvent as a result of the transfer to the MCorp Banks by MCorp of all, or any part, of the $400,000,000.

30. The transfer to the MCorp Banks by MCorp of all, or any part, of the $400,000,000 in cash and marketable securities, without reasonable equivalent value and fair consideration, will constitute a fraudulent transfer in violation of the Fraudulent Conveyance Statutes.

31. Plaintiffs will be irreparably harmed by such fraudulent conveyance.

32. Plaintiffs have no adequate remedy at law.

33. Plaintiffs are entitled to relief pursuant to the Fraudulent Conveyance Statutes.

COUNT II
(Fraudulent Transfer)

34. Plaintiffs repeat and reallege paragraphs 1 through 28 and paragraphs 29 through 34 of this Complaint.

35. Any transfer to the MCorp Banks by MCorp of all, or any part, of the $400,000,000 in cash and marketable securities will be with actual intent to hinder, delay or defraud plaintiffs in violation of 6 *Del. C.* § 1307 and 4 *Tex. Bus & Com.* Code Ann. § 24.008(a)(1).

36. Plaintiffs will be irreparably harmed by such fraudulent conveyance.

37. Plaintiffs have no adequate remedy at law.

38. Plaintiffs are entitled to relief pursuant to the Fraudulent Conveyance Statutes.

WREREFORE, plaintiffs respectfully request that this Court grant judgment as follows:

A. Pursuant to Count I, temporarily restraining and preliminarily and permanently enjoining MCorp from transferring to the MCorp Banks cash and marketable securities without receiving reasonable equivalent value and fair consideration;

B. Pursuant to Count II, temporarily restraining and preliminarily and permanently enjoining MCorp from transferring to the MCorp Banks cash or marketable securities; and

C. For such other and further relief as this Court deems just and proper.

/s/ Stephen R. Herrmann
R. Franklin Belotti
Stephen R. Herrmann
Richards, Layton & Finzer
One Rodney Square
P.O. Box 351
Wilmington, Delaware 13899
(302) 658-6541
Attorneys for Plaintiffs

Of Counsel:

Butler, Fitzgerald & Potter
A Professional Corporation
315 Park Avenue South
New York, New York 10010
(212) 473-1200

Date: November 9, 1988

UNITED STATES DISTRICT COURT
NORTHERN DISTRICT OF TEXAS
DALLAS DIVISION

No. CA3-88-2693-F

MCORP, PLAINTIFF

v.

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM, DEFENDANT

[Filed: Nov. 3, 1988]

FIRST AMENDED COMPLAINT AND APPLICATION FOR INJUNCTION

MCorp files its First Amended Complaint and Application for Injunction against Defendant Board of Governors of The Federal Reserve System as follows:

PARTIES

1. MCorp is a Delaware corporation which maintains principal places of business in Dallas and Houston, Texas.

2. The Board of Governors of the Federal Reserve System (the "Board") is an agency or instrumentality of the United States of America, which may be served with process herein by service of the Summons and Complaint on Marvin Collins, United States Attorney for the Northern District of Texas, 1100 Commerce Street, Dallas, Texas, by sending a copy thereof by registered mail to Richard Thornburgh, Attorney General of the United States, Washington, D.C., and by sending a copy thereof by certified mail to the Board in Washington, D.C.

JURISDICTION AND VENUE

3. This Court has jurisdiction of this action pursuant to 28 U.S.C. §§ 1331, 1337 and 2201 *et seq.*, and pursuant to the Federal Deposit Insurance Act, 12 U.S.C. § 1818.

4. Venue of this action in this District and Division is proper pursuant to 28 U.S.C. § 1391(b) and (d), and pursuant to 12 U.S.C. § 1818.

SUMMARY OF CLAIMS

5. MCorp is the second largest bank holding company in the State of Texas, with twenty-six bank subsidiaries throughout the state and almost twenty billion dollars in book value of consolidated assets. Throughout the unprecedented upheaval in the banking industry of Texas in recent years, MCorp has distinguished itself as a hardy survivor. As of October 1, 1988, MCorp was the only one of the eight largest Texas bank holding companies which had not been acquired by out-of-state interests, or made application for federal assistance.

6. Through a series of strategic management actions over the last decade, MCorp developed substantial value in a number of nonbank subsidiaries. In recent years, MCorp sold many of these subsidiaries at a significant profit. No other bank holding company in the region met with success in such efforts comparable to the success of MCorp. As a result, MCorp retains approximately $250 million in cash and other liquid assets today.

7. MCorp has not, of course, been unaffected by the severely depressed economic conditions that have afflicted virtually all major financial institutions in Texas. Its nonperforming assets have substantially grown since 1985, now exceed 1.5 billion dollars. It has sustained major losses in its banking subsidiaries. Accordingly, it made an early and voluntary decision in late 1986 to suspend dividends on its common stock. Finally, however, the collapse of the regional economy took its toll. As a result, MCorp on October 7, 1988, made a request that the Federal Deposit Insurance Corporation ("FDIC") provide MCorp's bank subsidiaries with federal assistance pursuant to 12 U.S.C. § 1823(c).

8. After October 7, 1988, MCorp remained in frequent contact with the Board. During such contacts, MCorp advised the Board that MCorp had scheduled a meeting of MCorp's Board of Directors for October 21, 1988, and that consideration would be given at such meeting to suspending dividends on MCorp's preferred stock, and to other steps to conserve MCorp's resources.

9. Despite this information, on an *ex parte* basis, and without notice of any kind to MCorp, the Board on October 19, 1988, issued Temporary Orders to Cease and Desist to MCorp in Docket No. 88-062-C-HL. The Temporary Orders to Cease and Desist prohibited certain actions by MCorp relating to the alleged potential dissipation of MCorp assets. This action was wholly without any factual or legal basis, in that MCorp had not taken any action which would justify a conclusion that it was about to dissipate its assets.

10. In fact, MCorp's Board of Directors at its October 21, 1988, meeting decided to suspend all dividends on its preferred stock and to impose a moratorium on payments of principal and interest on approximately $470 million in debt. This moratorium was not required by the Temporary Cease and Desist Orders, and will result in the conservation of tens of millions of dollars

of MCorp assets in excess of that required by the Board's precipitous and premature Orders.

11. Thus, it is indisputably clear that the *ex parte* Orders of the Board issued on October 19 were unfounded. MCorp never had and does not have any intention to dissipate its assets. Moreover, the Orders are unreasonable, oppressive, and render impractical the conduct of the normal business operations of MCorp. The October 19 Cease and Desist Orders therefore should be suspended, set aside and/or modified by this Court as expressly authorized in 12 U.S.C. § 1818(c)(2).

12. On October 26, 1988, the Board issued another Temporary Cease and Desist Order to MCorp, again on an *ex parte* basis and without notice to MCorp of any kind. This Order purports to require MCorp to "take such actions as are necessary to use all of its assets to provide capital support to its Subsidiary Banks in need of additional capital." The Order does not direct MCorp to actually provide such capital to Subsidiary Banks, but directs MCorp to report to the Board by November 10, 1988 "on the identity of those Subsidiary Banks into which capital injections will be made by MCorp and the amount of capital to be injected into each such Bank."

13. The October 26, 1988 Temporary Cease and Desist Order is based upon the "source of strength" theory outlined in policy statements and regulations of the Board, but not in any statute. According to the Board's theory, a bank holding company has an absolute duty to use all of its assets to provide capital to its subsidiary banks, and to disregard the rights of its shareholders and creditors with respect to such assets. The policy statements and regulations of the Board to this extent have no basis in the statutes which govern the Board, and exceed its legal authority. Accordingly, the October 26, 1988, Temporary Cease and Desist Order is without legal basis, and should be suspended, set aside, and/or modified by this Court as expressly authorized in 12 U.S.C. § 1818(c)(2).

FIRST CAUSE OF ACTION

(Preliminary and Permanent Injunction as to October 19 Temporary Cease and Desist Orders)

14. MCorp realleges Paragraphs 1 through 13 hereof.

15. The Temporary Cease and Desist Orders entered against MCorp by the Board without notice or hearing on October 19, 1988, are invalid and without basis in law or fact. The pendency of these Orders threatens MCorp with immediate and irreparable harm and injury for which there is no adequate remedy at law and which is likely to occur prior to a final hearing in this matter. In particular, MCorp is threatened with damage both to the prospects for a federally assisted recapitalization plan for MCorp's bank subsidiaries and to public confidence in MCorp and its bank subsidiaries. Accordingly, MCorp is entitled to preliminary and permanent injunctions suspending, setting aside, and/or modifying the Temporary Cease and Desist Orders entered against MCorp on October 19, 1988.

SECOND CAUSE OF ACTION

(Preliminary and Permanent Injunction as to October 26 Temporary Cease and Desist Order)

16. MCorp realleges Paragraphs 1 through 15 hereof.

17. The Temporary Cease and Desist Order entered against MCorp by the Board without notice or hearing on October 26, 1988, is invalid and without legal basis. The pendency of this Order threatens MCorp with immediate and irreparable injury for which there is no adequate remedy at law and which is likely to occur prior to a final hearing in this matter. In particular, MCorp is threatened with damage to the prospects for a federally assisted recapitalization plan for MCorp's bank subsidiaries, with damage to public confidence in MCorp and its bank subsidiaries, and with damage to the financial viability of MCorp and the legitimate interests of its shareholders and creditors. Moreover, if the asset

transfers contemplated by the Order were made, the result would be an irreparable violation of the fiduciary, statutory, and contractual obligation of MCorp to its shareholders and creditors. Accordingly, MCorp is entitled to preliminary and permanent injunctions suspending, setting aside, and/or modifying the Temporary Cease and Desist Order entered against MCorp on October 26, 1988.

WHEREFORE, PREMISES CONSIDERED, MCorp prays that the Board be required to appear and answer herein; that the Court enter a preliminary injunction on due notice and hearing, suspending, setting aside, and/or modifying the Temporary Cease and Desist Orders entered by the Board on October 19, 1988, and on October 26, 1988; that the Court on final hearing enter a permanent injunction suspending, setting aside, and/or modifying such Temporary Cease and Desist Orders; and that the Court grant such other and further relief to MCorp to which it may be entitled.

Respectfully submitted,

HUGHES & LUCE
2800 Momentum Place
1717 Main Street
Dallas, Texas 75201
(214) 939-5500
Thomas W. Luce, III
State Bar No. 12666000
David Bryant
State Bar No. 03281500

By: /s/ Thomas W. Luce III
ATTORNEYS FOR MCORP

VERIFICATION

I, Gene H. Bishop, Chairman of the Board of Directors and Chief Executive Officer of MCorp, state on my oath that I have read the foregoing pleading, and that the factual statements set forth therein are true and correct to the best of my knowledge and belief.

/s/ Gene H. Bishop
GENE H. BISHOP

THE STATE OF TEXAS)
)
COUNTY OF DALLAS)

The foregoing verification was sworn to before me on November 3rd, 1988 by Gene H. Bishop, Chairman of the Board of Directors and Chief Executive Officer of MCorp, a Delaware corporation, on behalf of said corporation.

/s/ [Illegible]
Notary Public in and for
the State of Texas

November 6, 1988

Gene M. Bishop
Chairman of the Board and
Chief Executive Officer
MCorp
Dallas, Texas 78265

Dear Mr. Bishop:

The Board of Directors of the Federal Deposit Insurance Corporation has met to consider your proposal to recapitalize the subsidiary banks of MCorp under Section 13(c) of the Federal Deposit Insurance Act. Our initial analysis indicates that your proposal is one that merits consideration by our Board. While there are problems with the proposal that we would like to discuss with you, we are prepared to commence negotiations on your proposal at once.

At the same time, as provided by FDIC policy, we will solicit proposals from third parties to determine the most effective and least cost resolution of this matter. We anticipate approximately a ten week period during which we would contact, screen and qualify investors, allow them to examine information on MCorp and its subsidaries, and do a limited amount of due diligence prior to formulating a proposal. It is expected that upon completion of the solicitation of proposals, as outlined herein, the FDIC Board of Directors would consider all proposals and would expect to reach a decision within two weeks.

While you and we are proceeding as outlined above, you agree to the following:

First, that MCorp use all reasonable efforts to maintain stability in all subsidiary banks. That is, MCorp will not initiate a voluntary liquidation of any subsidiary bank and it will seek to retain directors, officers and employees, and to maintain good relations with customers and depositors.

Second, that MCorp and its subsidiaries will, subject to the exercise of fiduciary responsibilities or what is believed by MCorp to be in the best interest of the company, use all reasonable efforts to refrain from seeking voluntary bankruptcy and to prevent an involuntary bankruptcy proceeding.

Third, that MCorp will use all reasonable efforts to assure that traditional inter-bank relationships, in particular inter-bank funding, among the subsidiary banks of MCorp be maintained generally at their current levels.

Finally, that MCorp allow potential investors selected by us to have free and open access to the books, records and personnel of MCorp and the banks. We will agree to appropriate confidentiality restraints on the material gathered.

The Office of the Comptroller of the Currency and the Federal Reserve Board have advised us that upon execution of this agreement by MCorp and its subsidiary banks, they will agree to a limited suspension of certain of their regulatory actions. The OCC will agree that with respect to its Notice of Intent to Issue Capital Directives, no response will be required for forty-eight hours following delivery of an additional letter from the OCC requiring such response. The OCC has further agreed that personal liability will not be pursued against the officers and directors of the subsidiary banks with respect to these Capital Directives. The Federal Reserve Board will agree to defer the time of submission of the report of capital injections required by its October 24, 1988 Temporary Order until five days following notice to MCorp by the Federal Reserve Board. Both agencies reserve their rights to fulfill all other regulatory responsibilities as to the banks and the holding company, including the initiation of other enforcement actions if circumstances require.

Further, as part of our evaluation of various options, the OCC, the Federal Reserve, and the FDIC will con-

tinue to monitor the situation at the various MBanks and will continue to evaluate assets and the financial condition of the banks.

We cannot provide any assurance that the FDIC will ultimately approve your 13(c) request for assistance.

We understand that this letter is not legally binding on either party, but represents our mutual expectations regarding the matters set forth herein, and can be terminated by either party at any time without prejudice.

Sincerely,

/s/ William Roelle
WILLIAM ROELLE
Associate Director

The undersigned acknowledge(s) and agree(s) to pursue an assistance transaction with the FDIC on the basis outlined above.

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM
Washington, D.C. 20951

November 7, 1988

John D. Hawke, Jr., Esq.
Arnold & Porter
1200 New Hampshire Avenue, N.W.
Washington, D.C. 20036

Dear Mr. Hawke:

We understand that the FDIC and MCorp have agreed, subject to certain understandings, to begin negotiations on a proposal for federal financial assistance under section 13(c) of the Federal Deposit Insurance Act. In particular, MCorp has represented to the FDIC that as part of the proposal you have put forward to the FDIC you are prepared to use the resources of MCorp to support that company's subsidiary banks.

In view of the negotiations described above, including MCorp's proposal to support its subsidiary banks, and during the time that such negotiations continue, we are authorized to represent to you as follows:

1. The Board will defer the time for submission of the report of capital injections required by its October 26, 1988, Temporary Cease and Desist Order (the "Order") until five days following notice to MCorp by the Board. As noted in our letter of October 30, 1988, the Order does not require MCorp to take any affirmative action with respect to MCorp assets prior to the submission of the report called for by the Order.

2. The Board will agree with MCorp to postpone the administrative and any judicial proceeding under the Notice of Charges, Amended Notice of Charges, and Order for a period of thirty days from the scheduled date of such proceeding. Prior to the expiration of this thirty

day extension, the Board is prepared to discuss with MCorp additional extensions of thirty days if the negotiations between MCorp and the FDIC are still continuing. The Board will agree with MCorp to extend the time within which MCorp must file an answer to the Notice of Charges issued on October 19, 1988, from November 8 to November 11, 1988.

You should be aware that during the period of negotiations the Board may, if it deems such action to be necessary, initiate enforcement action with respect to any violations of law and unsafe or unsound practices, including the issuance of further Temporary Orders To Cease and Desist requiring MCorp to make immediate capital injections into subsidiary banks with capital deficiencies.

Sincerely,

/s/ Michael Bradfield
MICHAEL BRADFIELD

/s/ William Taylor
WILLIAM TAYLOR

UNITED STATES OF AMERICA
BEFORE THE BOARD OF GOVERNORS
OF THE FEDERAL RESERVE SYSTEM
WASHINGTON, D.C.

No. 88-062-B-A2-HC

IN RE MCORP, DALLAS, TEXAS

[Filed: May 24, 1989]

SECOND AMENDED NOTICE OF CHARGES AND OF HEARING ISSUED PURSUANT TO THE FEDERAL DEPOSIT INSURANCE ACT, AS AMENDED, AND THE BANK HOLDING COMPANY ACT OF 1956, AS AMENDED

The Board of Governors of the Federal Reserve System (the "Board of Governors") has reasonable cause to believe that MCorp, Dallas, Texas ("MCorp"), a registered bank holding company, has engaged, is engaging and, unless restrained, will continue to engage in unsafe and unsound practices and violations of law and regulation in conducting the business of MCorp, and that, as a result of the unsafe and unsound practices and violations, the financial condition of MCorp and its subsidiary banks are likely to be adversely affected.

Accordingly, the Board of Governors hereby institutes this proceeding for the purpose of determining whether an appropriate order to cease and desist should be issued against MCorp and issues this second amended Notice of

Charges and of Hearing (the "Second Amended Notice"), which amends the Notice of Charges and of Hearing issued against MCorp on October 19, 1988 and the Amended Notice of Charges and of Hearing issued against MCorp on October 26, 1988 (the "Amended Notice"), in implementation thereof pursuant to the provisions of sections 8(b)(1) and 8(b)(3) of the Federal Deposit Insurance Act, as amended (the "Act") (12 U.S.C. 1818(b)(1) and (3)), section 5(b) of the Bank Holding Company Act of 1956, as amended (the "BHC Act") (12 U.S.C. 1844(b)) and the Board of Governors' Rules of Practice for Hearings (12 CFR Part 263).

In support of this Second Amended Notice, the Board of Governors alleges the following:

1. MCorp, a corporation existing and doing business under the laws of the State of Delaware, is, and has been at all times pertinent to the charges herein, a registered bank holding company. MCorp, therefore is, and has been at all times pertinent to the charges herein, subject to the Act (12 U.S.C. 1818 *et seq.*), the BHC Act (12 U.S.C. 1841 *et seq.*) and the rules and regulations of the Board of Governors (12 CFR 201 *et seq.*).

2. Until March 29, 1989, MCorp owned 25 subsidiary banks and 17 active nonbank subsidiaries, and, by virtue of such ownership, controlled the affairs and management of the 25 subsidiary banks and the nonbank subsidiaries. All of the subsidiary banks were national banks subject to the primary regulatory jurisdiction of the Office of the Comptroller of the Currency (the "OCC").

3. On November 4, 1986, MCorp entered into a Memorandum of Understanding (the "MOU") with the Federal Reserve Bank of Dallas (the "Reserve Bank"), which provided, *inter alia*, that "MCorp will take all necessary steps to ensure that adequate capital positions are maintained at the holding company and at each of its subsidiary banks and nonbank subsidiaries".

4. The Minimum Capital Ratios Regulation of the OCC (12 CFR Part 3) provides that the minimally ac-

ceptable ratio of primary capital to total assets for national banking institutions is 5.5 percent unless a higher minimum capital ratio requirement is established for a bank in light of the particular circumstances of that bank.

5. On March 28 and 29, 1989, following a series of events, 20 of MCorp's 25 subsidiary banks were declared insolvent and closed by the OCC. In particular:

(a) As of September 30, 1988, 22 of MCorp's then existing 25 bank subsidiaries had primary capital ratios below 5.5 percent of their total assets.

(b) On October 7, 1988, MCorp requested that the Federal Deposit Insurance Corporation provide MCorp with federal financial assistance, pursuant to section 13 (c) of the Act (12 U.S.C. 1823(c)). The Federal Deposit Insurance Corporation subsequently informed MCorp, as a condition to proceeding with such assistance, MCorp should immediately use its available assets to support its subsidiary banks.

(c) On October 24, 1988, MCorp announced that the board of directors of MCorp declared a moratorium on the payment of principal and interest on all parent company public and privately placed indebtedness for borrowed money.

(d) As of October 26, 1988, the Board of Governors had reasonable cause to believe that, based on the volume of classified assets at the 25 MCorp banks, their earnings and other related factors, some of those 25 banks were in danger of failing in the absence of increases in their capital accounts. On October 26, 1988, the Board of Governors initiated a cease and desist proceeding and issued a temporary order to cease and desist against MCorp designed to ensure that MCorp takes such actions that were necessary to provide capital support to its banks that were in need of additional capital.

(e) On or about October 27, 1988, the OCC issued to 18 of the MCorp banks notices of its intent to issue capital directives, pursuant to the International Lending

Supervision Act of 1983 (12 U.S.C. 3907 *et seq.*), that (1) required these banks to attain primary capital ratios of 4.5 percent as an interim requirement, and (2) provided these banks with a period of two days to respond to the OCC's notices.

(f) On or about November 6, 1988, negotiations were commenced between MCorp and the Federal Deposit Insurance Corporation for purposes of considering a proposal by MCorp to recapitalize its subsidiary banks with the aid of federal financial assistance on an open bank basis. In consideration of the plan, MCorp and the Board of Governors agreed to postpone the hearing directed by the Amended Notice and to defer the submismission of the report of financial assistance required by the temporary order issued on October 26, until 5 days after notice to MCorp by the Board of Governors.

(g) On March 21, 1989, involuntary bankruptcy proceedings were instituted against MCorp in New York.

(h) On March 28, 1989, the Federal Deposit Insurance Corporation decided not to provide any open bank assistance to any of MCorp's subsidiary banks.

(i) On March 28, 1989, the OCC found MBank-Dallas, one of MCorp's subsidiary banks, to no longer be viable as a privately funded institution.

(j) As a result of the OCC's finding and other factors, the Reserve Bank decided not to extend additional credit to MBank Dallas and demanded repayment of MBank Dallas' demand note.

(k) Despite repeated assurances of MCorp management that MCorp would act to support its then 25 subsidiary banks and the provisions of the MOU with the Reserve Bank described in paragraph 3 hereof, MCorp has failed to meet the capital needs of its subsidiary banks. Twenty of MCorp's 25 banks were declared insolvent and were closed by the OCC on March 28 and 29, 1989.

6. As of the date of this Second Amended Notice, MCorp continues to own five subsidiary banks—MBank

El Paso, N.A., El Paso, Texas, MBank Corpus Christi, N.A., Corpus Christi, Texas ("MBank Corpus"), MBank Waco, N.A., Waco, Texas ("MBank Waco"), MBank Brownsville, N.A., Brownsville, Texas and MBank New Braunfels, N.A., New Braunfels, Texas ("MBank New Braunfels"). MCorp, by virtue of such ownership of these five subsidary banks (referred to herein collectively as the "Subsidiary Banks"), controls the affairs and management of the Subsidiary Banks. All of the Subsidiary Banks are subject to the primary regulatory jurisdiction of the OCC.

7. The remaining Subsidiary Banks continue to have inadequate levels of capital protection, and they are suffering losses and erosions of their deposit bases. In particular:

(a) As of the date of this Second Amended Notice, internal reports and call report statements generated by each of the Subsidiary Banks indicate that three of the Subsidiary Banks have stated primary capital ratios below 5.5 percent of their total assets, the minimum ratio established for such banks by the regulations of the OCC: MBank Corpus (4.72 percent), MBank Waco (3.54 percent), and MBank New Braunfels (1.38 percent). In order to increase the stated primary capital ratios of these banks to the minimum level established by the OCC regulations, an additional capital investment of approximately $21 million would be necessary.

(b) The Subsidiary Banks are each experiencing deposit erosion and four of the five are incurring losses.

(c) The Board of Governors has reasonable cause to believe that, based on the volume of classified assets at the Subsidiary Banks, their earnings and other related factors, some of the Subsidiary Banks are in danger of failing in the absence of increases in their capital accounts.

(d) On May 1, 1989, the OCC sent letters to each of MCorp's Subsidiary Banks. The letters requested that

the Subsidiary Banks each submit to the OCC withtin 30 days of their receipt of these letters capital plans designed to increase and/or maintain the capital of the Subsidiary Banks at appropritae regulatory standards. The Board of Governors has reasonable cause to believe that the Subsidiary Banks have no independent, outside sources of capital other than from their parent bank holding company, MCorp.

8. (a) As of the date of this Second Amended Notice, the Board of Governors has reason to believe that MCorp has sufficient assets to make additional investments in the capital accounts of the Subsidiary Banks to bring them to the minimum capital levels described in paragraph 4 hereof.

(b) The Board of Governors has reason to believe that the additional investment by MCorp in its wholly owned Subsidiary Banks would cause the Subsidiary Banks to remain as valuable assets of MCorp, thereby providing MCorp with a potential source of future income.

9. Given MCorp's past failure to support adequately its subsidiary banks, its failure to comply with the capital provision of the MOU, and representations by MCorp management to the staff of the Reserve Bank and the Board of Governors, the Board of Governors has reasonable cause to believe that MCorp will not make all reasonable efforts to assure that the Subsidiary Banks have levels of capital protection at or above the standards set by the Subsidiary Banks' primary federal regulator. In particular:

(a)(1) Section 5(b) of the BHC Act (12 U.S.C. 1844(b)) provides that:

> The Board is authorized to issue such regulations and orders as may be necessary to enable it to administer and carry out the purpose of this chapter [the BHC Act] and prevent evasions thereof.

(2) Section 225.4(a)(1) of Regulation Y of the Board of Governors (12 CFR 225.4(a)(1)) provides that:

> A bank holding company shall serve as a source of financial and managerial strength to its subsidiary banks and shall not conduct its operations in an unsafe or unsound manner.

(b) The Board of Governors' Policy Statement on the responsibility of bank holding companies to act as sources of strength to their subsidiary banks provides that a bank holding company's failure to provide assistance to a subsidiary bank in weakened or failing condition when the holding company is in a position to provide the support will be viewed as an unsafe and unsound banking practice and a violation of Regulation Y.

(c) By failing to make all reasonable efforts to assure that the capital of its subsidiary banks, including the five Subsidiary Banks described in paragraph 6 hereof, complies with minimum regulatory standards as the financial conditions of such banks have deteriorated, MCorp and its management improperly limited the company's ability to enhance the banks' capital and, thereby, threatened and continue to threaten the continued financial viability of the Subsidiary Banks. Thus, MCorp and its management have engaged in an unsafe and unsound practice, a violation of section 225.4(a)(1) of Regulation Y of the Board of Governors, and a violation of the capital provision of the MOU, and are continuing such practices and violations, that adversely affect MCorp's condition and the conditions of its subsidiary banks and that limit MCorp's ability to serve as a source of financial strength to the banks.

(d) The Board of Governors has reasonable cause to believe that MCorp and its management will fail to use its available resources to prevent the continued deterioration of the subsidiary Banks and thereby will engage in an unsafe and unsound banking practice, a violation of

section 225.4(a)(1) of Regulation Y of the Board of Governors, and a violation of the MOU that would adversely affect MCorp's condition and the conditions of the Subsidiary Banks and that would limit MCorp's ability to serve as source of financial strength to the Subsidiary Banks.

10. MCorp and its management have failed to operate MCorp and the subsidiary banks in a safe, sound and lawful manner as set forth in paragraphs 3, 4, 5, 6, 7, and 8 hereof.

11. On March 31, 1989, MCorp and two of its nonbank subsidiaries filed petitions for voluntary bankruptcy pursuant to Chapter 11 of the Federal Bankruptcy Code. MCorp has initiated an adversary proceeding in bankruptcy court against the Board seeking preliminary and permanent injunctive relief preventing the Board from reactivating these proceedings. As of the date of this notice, no relief has been granted. The Board of Governors is of the opinion that the commencement and continuation of the proceedings against MCorp instituted by this Second Amended Notice would not be effected by the provisions of the Federal Bankruptcy Code.

12. Notice is hereby given that a hearing will be held on July 12, 1989, at the Federal Reserve Bank of Dallas for the purpose of taking evidence on the charges hereinbefore specified in order to determine whether an appropriate order should be issued under the Act and the BHC Act requiring MCorp to cease and desist from the unsafe or unsound practices and violations of law and regulation herein specified or to take affirmative action as may be appropriate under the circumstances of this matter, including a requirement that MCorp immediately make such additional investments in its Subsidiary Banks as is necessary to assure that those banks meet and will continue to meet the minimum capital standards prescribed by the applicable capital adequacy regulations or guidelines of the OCC or such higher

minimum capital requirements as the OCC, in its discretion, deems necessary or appropriate for such bank pursuant to sections 3.9-3.13 of the OCC's minimum capital regulations. 12 C.F.R. 3.9-3.13.

13. The hearing referred to in paragraph 12 hereof shall be held before an administrative law judge to be appointed by the United States Office of Personnel Management pursuant to section 3344 of Title 5 of the United States Code (5 U.S.C. 3344). The hearing shall be private, unless the Board of Governors shall determine that a public hearing is necessary to protect the public interests, and in all other aspects shall be conducted in compliance with the provision of the Act and the Board of Governors' Rules of Practice for Hearings.

14. Authority is hereby delegated to the Secretary of the Board of Governors to designate the time and place and presiding officer for any hearing that may be conducted on this Second Amended Notice and take any and all actions that the presiding officer would be authorized to take under the Board of Governors' Rules of Practice for Hearings with respect to this Second Amended Notice and any hearing to be conducted hereon, until such time as a presiding officer shall be designated by the United States Office of Personnel Management and by the Secretary of the Board of Governors as provided herein.

15. The provisions of this Second Amended Notice do not supersede, modify, or, any manner, affect the provisions of the Notice of Charges and of Hearing issued against MCorp and MCorp Management, Dallas, Texas by the Board of Governors on March 30, 1989, or the status of the temporary orders issued on October 19 and 26, 1988.

16. MCorp is hereby directed to file an answer to this Second Amended Notice within 20 days of service of this Second Amended Notice as provided by section 263.5 (a) of the Rules of Practice for Hearings of the Board of the Board of Governors (12 CFR 263.5(a)). As provided in section 263.5(d) of the Rules of Practice for Hearings of the Board of Governors (12 CFR 263.5 (d)), the failure of MCorp to file an answer required by this Second Amended Notice within the time provided herein shall constitute a waiver of MCorp's right to appear and contest the allegations of this Second Amended Notice and authorization for the presiding officer, without further notice to MCorp, to find the facts to be as alleged in this Second Amended Notice and to file with the Secretary of the Board of Governors a recommended decision containing such findings and appropriate conclusions.

Dated at Washington, D.C., this *24th* day of May, 1989.

BOARD OF GOVERNORS OF THE
FEDERAL RESERVE SYSTEM

By: /s/ William W. Wiles
WILLIAM W. WILES
Secretary of the Board

UNITED STATES BANKRUPTCY COURT
SOUTHERN DISTRICT OF TEXAS
HOUSTON DIVISION

Jointly Admin. Chap. 11 Case Nos.
89-02312-H3-11, 89-02324-H5-11, and 89-02848-H2-11
Adversary Proc. No. 89-0298

IN RE: MCORP FINANCIAL, INC, ETC.,
MCORP MANAGEMENT, and MCORP, ETC., DEBTORS.

MCORP, MCORP FINANCIAL, INC., and MCORP
MANAGEMENT, DEBTORS IN POSSESSION, PLAINTIFFS

v.

THE BOARD OF GOVERNORS OF THE FEDERAL RESERVE
SYSTEM OF THE UNITED STATES OF AMERICA, DEFENDANT

[Filed: June 2, 1989]

OFFER OF PROOF IN SUPPORT OF EMERGENCY MOTION FOR PRELIMINARY INJUNCTION

MCORP, MCORP FINANCIAL, INC. and MCORP MANAGEMENT hereby make the following offer of proof in support of their Emergency Motion for a Preliminary Injunction in the above-captioned adversary proceeding:

Peter Bartholow, Chief Financial Officer and Group Chairman—Planning and Finance of MCorp and MCorp

Management and President and a Director of MCorp Financial, Inc. ("MCorp Financial") will testify to the following facts:

1. Prior to March 28, 1989, MCorp and MCorp Financial, its wholly owned subsidiary, were holding companies for MCorp Management, 25 MBanks, MVestment (itself a holding company for MTrust Corp., N.A., a trust company and related investment advisory entities), and approximately 17 non-bank subsidiaries. MCorp Management supplied management, financial and advisory services to MCorp, MCorp Financial and their other bank and non-bank subsidiaries.

2. There are no paid employees of either MCorp or MCorp Financial. Prior to September 30, 1988, MCorp Management employed approximately 350 persons, most of whom spent substantially all of their time performing services related to the 25 MBanks including audit, loan review, accounting, tax, financial planning, investment, and human resources services. On October 1, 1988, approximately 340 of the 350 employees of MCorp Management were transferred from its payroll to the payroll of certain MBanks. Prior to September 30, 1988, MCorp Management charged the MBanks and other entities in the MCorp family for the services rendered to them by MCorp Management personnel. After October 1, 1988, the MBanks to which the former MCorp Management employees were transferred charged MCorp, MCorp Financial and MCorp Management for services rendered by the transferred employees to those entities. As a result, there was no substantial economic impact on MCorp Management or the MBanks by virue of the transfer of personnel that was effected on October 1, 1988.

3. MCorp began efforts to recapitalize MCorp, MCorp Financial and the MBanks in the late spring or early summer of 1988. Those efforts included discussions with the Federal Deposit Insurance Corporation ("FDIC"), the Office of the Comptroller of the Currency ("Comp-

troller") and staff of the Board of Governors of the Federal Reserve System of the United States of America ("Board") (collectively the "Regulators").

4. On October 7, 1988, MCorp submitted to the FDIC a formal written proposal for the comprehensive recapitalization of the MBanks and a restructure of the debt and equity of MCorp and MCorp Financial. That proposal contemplated that all of the financial assets and resources of MCorp, then having a value of approximately $360 million, would be dedicated to the financial support of the MBanks; that MCorp would raise between $350 and $400 million of new capital from private sources that would be dedicated to the comprehensive restructuring and recapitalization of MCorp and the MBanks; and that substantial financial assistance for the MBanks would be made available and committed by the FDIC. The elements of that proposal had been discussed with the FDIC, the Comptroller and the Board over a period of several months prior to October 7, 1988.

5. Within two weeks after MCorp submitted its proposal to the FDIC, the Board served MCorp with a Notice of Charges dated October 19, 1988 and two temporary cases and desist orders, each dated October 19, 1988 and Exhibit 2 is the two temporary cease and desist orders.

6. The first cease and desist order prohibited MCorp from paying dividends on its common and preferred stock. MCorp had not paid dividends on its common stock since the last quarter of 1986. Although it had continued to pay dividends on its preferred stock through the third quarter of 1988, MCorp had advised the Regulators that MCorp's board of directors would consider, at a meeting scheduled to be held on October 24, 1988, the discontinuance of dividends on its preferred stock in order to husband its assets for use in connection with the proposed recapitalization plan submitted to the FDIC. MCorp's management also indicated that its board of directors would consider the declaration of a moratorium on the payment of principal of and interest on

all of McCorp's borrowed money debt. Furthermore, prior to October 19, 1988, MCorp advised the Regulators that MCorp was prohibited from the payment of preferred stock dividends because of certain covenants in MCorp's debt agreements.

7. The second temporary cease and desist order prohibited MCorp from entering into any transaction or taking any action that would result in the dissipation of its assets. Specifically exempted from the restraints of the second temporary cease and desist order were (a) the continued payment of principal and interest on MCorp's borrowed money debt, (b) the payment of salaries to employees (but not bonuses) and (c) the payment for goods and services obtained by MCorp pursuant to agreements entered into in the ordinary course prior to October 19, 1988. Shortly after the second temporary cease and desist order was issued, MCorp complained to the Board that the second temporary cease and desist order was phrased in such a manner that it did not know which of its obligations it could pay without violating that temporary cease and desist order and sought relief from and clarification by the Board on that issue. The only relief offered by the Board was to require MCorp to seek permission of the Board for each payment MCorp believed might be prohibited by the second temporary cease and desist order.

8. On October 24, 1988, MCorp's board of directors suspended the declaration and payment of dividends on its preferred stock and declared a moratorium on the payment of all principal of and interest on all borrowed money debt of MCorp, effective as of October 21, 1988.

9. Without warning from the Board and while the discussions about the second temporary cease and desist order were being carried on by representatives of the Board and MCorp, the Board issued an Amended Notice of Charges and a third temporary cease and desist order, Exhibits 3 and 4, respectively, on October 26, 1988. The Amended Notice of Charges informed MCorp that, on the

following day, October 27, 1988, the Comptroller would issue to 18 of the MBanks, notices of intent to issue capital directives to the 18 banks requiring those banks to submit plans to the Comptroller to raise additional capital. The third temporary cease and desist order required MCorp to prepare to infuse its financial assets, approximating $360 million in value, into the 18 MBanks and to submit to the Board, within 15 days, a plan stating the assets to be contributed as capital to each of the 18 MBanks, and the identity of each such MBank. The Comptroller issued such notices of intent to 18 of the MBanks on October 28, 1988.

10. After the receipt of the third temporary cease and desist order, MCorp advised the Board and the other Regulators that it would not comply with that order or any other order requiring it to downstream its assets into the undercaptialized MBanks because such action would have constituted a waste of MCorp's assets, fraudulent conveyances of those assets, and a violation of Delaware law subjecting MCorp and its officers and directors to personal liability unless, as part of the same transaction, the FDIC would provide substantial financial assistance to the MBanks and MCorp was able to effect a restructure of its debt and equity as part of a global transaction. MCorp requested the FDIC to commit to provide open bank assistance to the MBanks if MCorp made the capital infusions referred to in the Amended Notice of Charges, and the FDIC refused to make such a commitment at that time or to assure MCorp that it would make such a commitment at any time in the future.

11. Within ten days after the receipt of the third temporary cease and desist order, MCorp commenced an action against the Board in the United States District Court for the Northern District of Texas, Dallas Division, seeking an order suspending or rescinding the three temporary cease and desist orders issued by the Board. Exhibit 7 is the First Amended Complaint in that action.

12. During this period, the Board of Directors of MCorp received a letter dated October 25, 1988, Exhibit 5, threatening MCorp with legal action, including the filing of an involuntary chapter 11 petition against MCorp, if MCorp made or attempted to make capital contributions of its assets to the MBanks. In addition, during early November, 1988, one of MCorp's creditors, Charlifco filed an action against MCorp in the Chancery Court for the State of Delaware seeking an injunction against MCorp is [*sic*] making capital contributions to the MBanks. The complaint in that action is Exhibit 6.

13. Prior to November 6, 1988, MCorp advised all of the Regulators that if it was compelled to downstream substantial assets into the MBanks, as contemplated by the Amended Notice of Charges, MCorp would be compelled to seek relief pursuant to chapter 11 of the Bankruptcy Code. As a result of intensive negotiations with the Regulators, on November 6, 1988, MCorp and the FDIC entered into an agreement, Exhibit 8, that is referred to as a standstill agreement. On the following day, MCorp entered into a standstill agreement with the 18 MBanks to which the notices of intent to issue capital directives had been issued.

14. Under the terms of the standstill agreement with the FDIC, the FDIC acknowledged that MCorp's recapitalization proposal of October 7, 1988 merited consideration and further discussion and agreed to commence negotiations with MCorp immediately. The FDIC advised MCorp that it would solicit bids from other parties to acquire the MBanks or MCorp and the MBanks, and MCorp agreed that it would make available its books, records and personnel and would use its best efforts to make available the books, records and personnel of the MBanks to all prospective bidders qualified and approved by the FDIC. MCorp also agreed to use all reasonable efforts to maintain intact the then existing funding arrangements between and among the MBanks. Finally, MCorp agreed that it would not file a voluntary chapter 11 case and would use reasonable efforts to prevent others

from filing an involuntary chapter 11 case, provided that such actions were consistent with MCorp's fiduciary duties and obligations to its creditors and shareholders.

15. The standstill agreement between MCorp and the Board provided that the Board would take no further action with respect to the third temporary cease and desist order, the Amended Notice of Charges, and MCorp and the Board agreed that the pending action in the United States District Court for the Northern District of Texas against the Board would be suspended while the FDIC negotiated MCorp's recapitalization plan and other bidders were given an opportunity to conduct due diligence investigations of MCorp and the MBanks and bids were solicited.

16. During the same period, the Comptroller agreed that the MBanks that had received notices of intent to issue capital directives would not have to respond to those notices and further agreed that the officers and directors of those banks would not be subject to civil money penalties for failure to raise additional capital.

17. The FDIC standstill agreement contemplated that the due diligence and bidding process would take approximately ten weeks and that the FDIC would make a decision on which proposal to accept within a period of approximately two weeks after the ten week period expired.

18. Between October 19, 1988 and March 28, 1989, MCorp complied in all respects with the provisions of the first two temporary cease and desist orders. Furthermore, MCorp has complied with those orders right up to the present date. The Board has never complained to MCorp that it did not comply with those orders.

19. Between November 6, 1988 and March 28, 1989, MCorp complied in all respects with its obligations under under the standstill agreements with the Board, the Comptroller and the FDIC and none of them complained to MCorp that it failed to comply with those obligations.

20. The FDIC failed to conduct any meaningful, substantive negotiations of its recapitalization proposal dated October 7, 1988, between October 7, 1988 and March 28, 1989. MCorp made numerous attempts to conduct meaningful negotiations with the FDIC, but on each occasion was advised by the FDIC that the FDIC was not yet prepared to discuss the development or terms of a comprehensive recapitalization plan.

21. On March 24, 1989, MCorp learned for the first time that an involuntary chapter 7 petition had been filed against it in the United States Bankruptcy Court for the Southern District of New York on March 21, 1989. MCorp learned of that filing by a telephone call from a reporter for the *Wall Street Journal*. That day was Good Friday and I had accompanied my family to visit friends in East Texas. Gene H. Bishop, Chairman of the Board and Chief Executive Officer of MCorp also was out of the city with his family.

22. Over the weekend, Mr. Bishop, I, other senior officers of MCorp and its regular corporate counsel and bankruptcy counsel were called and we met in Dallas on Sunday, March 26, 1989. When we returned to Dallas, we immediately contacted the senior officers of each of the MBanks to notify them of the filing of the involuntary petition and to make plans to deal with the concerns that undoubtedly would be raised by customers, depositors and borrowers of the MBanks when the news of the involntary chapter 7 filing became public on Monday morning, March 27, 1989.

23. On Sunday, March 26, we also contacted Robert Clarke, the Comptroller, to advise him of the filing of the involuntary chapter 7 petition. We did not immediately contact the FDIC or the Board because Mr. Clarke requested that we give him an opportunity to advise the FDIC and the Board of the filing of the involuntary petition. By late that evening, we were in direct communication with the Board and the Comptroller to discuss the filing of the involuntary petition and the plans and

preparations we and the MBanks were making to deal with the situation.

24. Later on Tuesday, March 28, 1989, we learned from officials of the MBanks and the Comptroller that teams of personnel from the FDIC and the Comptroller were arriving at all of the MBanks. Within a matter of hours, we were advised that the Comptroller had determined to declare MBank Dallas and MBank Houston insolvent. Over the night of March 28 and early in the morning of March 29, the Comptroller declared 18 additional MBanks insolvent and closed them, appointing the FDIC as receiver of all 20 of the closed MBanks.

25. The 20 MBanks closed by the Comptroller on the night of March 28-29, 1989 included the MBanks previously referred to in the Amended Notice of Charges dated October 26, 1988 which hade been the recipients of the Comptroller's Notice of Intent to Issue Capital Directives, except for MBank New Braunfels. MBank New Braunfels was not declared insolvent or closed.

26. As a consequence of the actions of the Comptroller on the night of March 28-29, 1988, the charters of the 20 MBanks declared insolvent were revoked, those banks no longer exist, and those banks are no longer owned or controlled by MCorp or MCorp Financial. Certain of the assets and all of the deposit liabilities, liabilities to customers, liabilities to creditors of the closed MBanks, except for their liabilities to their parents and affiliates, were transferred to and assumed by the Deposit Insurance Bridge Bank, a newly chartered national bank that is wholly owned and controlled by the FDIC.

27. A copy of the joint press release issued by the Comptroller and the FDIC on March 29, 1989, is Exhibit 10. As to MBank New Braunfels, it and four other MBanks continue to be owned and controlled by MCorp. However, in recent call reports filed with the Comptroller by MBank New Braunfels, its primary capital ratio, on a risk adjusted basis, is in excess of the minimum capital requirements of the Comptroller. Accordingly, MCorp is

of the view that the Amended Notice of Charges dated October 26, 1988 and the third temporary cease and desist order dated the same day are moot because the MBanks into which the Board attempted to require MCorp to infuse as assets, other than MBank New Braunfels, no longer exist, and MBank New Braunfels has capital in excess of the minimum capital requirements of the Comptroller on a risk-adjusted basis.

28. On or immediately after March 27, 1989, MCorp announced publicly that it intended to convert the involuntary chapter 7 petition that was filed in New York to a voluntary chapter 11 case and to transfer that chapter 11 case from the Southern District of New York to the United States Bankruptcy Court for the Southern District of Texas, Houston Division. It also announced that MCorp Financial and MCorp Management intended to file voluntary chapter 11 petitions in the Southern District of Texas. These public announcements also stated that the filing of the chapter 11 petitions of the three companies would not have any effect on the business of the five remaining MBanks and MTrust Corp., their depositors, customers or other creditors.

29. As previously indicated, on March 28, 1989, MCorp was still in compliance with all of its obligations pursuant to the standstill agreements reached with the Regulators.

30. Nevertheless, on March 30, 1989, the Board issued a new Notice of Charges, Exhibit 12, to MCorp and MCorp Management. That Notice of Charges alleged that MCorp and MCorp Management had engaged, were engaging and, unless restrained, would continue to engage in violations of Section 23A of the Federal Reserve Act in that MCorp and MCorp Management caused MBank Houston and MBank Dallas (as successor by merger to MBank Preston) to extend to Corp Management, unlawful, unsecured extensions of credit.

31. At the time of the issuance of the March Notice of Charges, both MBank Houston and MBank Dallas al-

ready had been closed. The transaction on which the March Notice of Charges is based arose out of transactions that commenced in August, 1985 when MBank USA was organized to purchase from MBank Houston and MBank Preston the assets of the credit card portfolios of those banks. MBank USA was a wholly-owned subsidiary of MNet, itself a wholly-owned subsidiary of MCorp Financial.

32. In that transaction, MBank USA paid MBank Preston and MBank Houston an amount equal to the amount owed by customers on their credit card accounts as of the date of sale, plus a premium for the going concern value of the credit card operations, and further agreed to pay, as "Additional Contingent Fees" the lesser of a fixed sum or a sum equal to a percentage of MBank USA's monthly net income until the earlier of the payment of a specified amount to each of those banks or December 31, 1993. Exhibits 13 and 14 are letter agreements between MBank USA and MBank Houston dated August 1, 1985, and MBank USA and MBank Preston, dated October 9, 1985, embodying the Additional Contingent Fee arrangements.

33. MBank Houston and MBank Preston agreed to sell federal funds to MBank USA in order to provide it with working capital with which to conduct and expand its credit card operations, in exchange for which MBank USA agreed to pay interest on the federal funds so provided to MBank Houston and MBank Preston.

34. In the Fall of 1986, MCorp agreed to sell the stock of MNet to Lomas & Nettleton Financial Corporation ("Lomas") for approximately $300 million in cash, promissory notes of Lomas, and two series of Preferred Stock of Lomas, all pursuant to a Stock Purchase Agreement dated as of November 16, 1986. However, as part of that agreement, Lomas required MBank USA to discontinue its obligation to pay a portion of its net profits to MBank Houston and MBank Preston as Additional Contingent Fees.

35. To substitute for the Additional Contingent Fee arrangement previously agreed to by MBank USA, MCorp Management agreed to enter into Release Agreements with MBank Preston and MBank Houston dated December 30, 1986, that are Exhibits 15 and 16. Under those Release Agreements, MCorp Management agreed to pay to MBank Preston and MBank Houston additional contingent payments in an amount equal to the lesser of (a) the sum of interest and dividends actually received by MCorp Management on the Lomas notes and Preferred Stock or (b) quarterly cash payments aggregating $2,853,000 and MBank Houston and MBank Preston agreed to release MBank USA from the Additional Contingent Fee profit sharing arrangement provided for in Exhibits 13 and 14. Consequently, the original Additional Contingent Fee obligations were replaced by new contingent payment obligations geared to the interest and principal payments on the Lomas notes and Preferred Stock.

36. The Board was concerned about certain aspects of the transaction between MCorp and Lomas at or about the time that transaction occurred. The transaction was reviewed with representatives of the Board by members of the management of MCorp. The Board did not criticize the MNet transaction or MCorp Management's role in that transaction either in December of 1986 or thereafter until March, 1989.

37. Although the Board examined MCorp and its subsidaries on numerous occasions between September 30, 1986 and January, 1989, the Board never criticized or questioned the MNet transaction until the end of February or early March, 1989.

38. Furthermore, the Comptroller, as primary regulator of MBank Houston and MBank Dallas, conducted numerous examinations of those institutions and other MBanks between March 31, 1986 and January, 1989. The Comptroller has never criticized or raised questions

about the MNet transaction or MCorp Management's obligations to MBank Dallas or MBank Houston.

39. When the March Notice of Charges was issued to MCorp and MCorp Management on March 30, no money was then due from MCorp Management to Bank Dallas or Bank Houston on account of the contingent payment obligation assumed by MCorp Management pursuant to Exhibits 15 and 16.

40. Prior thereto, MCorp Management had made certain of these contingent payments to MBank Dallas and MBank Houston for 1987. However, in contemplation of the merger of MBank Preston into MBank Houston and because MBank Dallas and MBank Houston were obligated to MCorp Management for financial support and management services in amounts substantially in excess of the contingent payments then due for MCorp Management to the Banks, MCorp Management did not make contingent payments to MBank Dallas and MBank Houston for 1988 and, in effect, set them off against the payments due from the banks. At this time, the receivership estates of MBank Dallas and MBank Houston are indebted to MCorp Management because of financial support and management services provided to those banks by MCorp Management, after taking into account all contingent payments due from MCorp Management to those banks.

41. MCorp Management and MCorp dispute the charges contained in the March Notice of Charges that is Exhibit 17, preserving all rights with respect to the automatic stay under Section 362 of the Bankruptcy Code. MCorp and MCorp Management never borrowed money from MBank Houston or MBank Preston (as predecessor to MBank Dallas) in connection with the MNet or MBank USA transaction that occurred in December 1986. Nor did MCorp or MCorp Management receive an extention of credit from MBank Preston or Bank Houston in connection with that transaction. In fact, MCorp Management never received any consideration of any kind from either MBank Houston or MBank

Preston in connection with the 1986 MNet transaction with Lomas or as a result of that transaction. In the 1986 transaction pursuant to which MBank USA and MNet were sold to Lomas, both banks released MBank USA from any continuing obligation under the Additional Contingent Fee agreement.

42. As Chief Financial Officer of MCorp since 1980 and as Chief Financial Officer of MCorp Management since 1984, Mr. Bartholow will testify that neither of those entities has ever caused MBank Preston, MBank Dallas or MBank Houston to violate Section 23A of the Federal Reserve Act. Nor did they cause any other MBank now in existence or closed on March 28 to violate Section 23A. It is not the intention of MCorp, MCorp Financial or MCorp Management to violate or cause any of the five remaining MBanks to violate Section 23A and they are well aware of their obligations to comply with all existing banking and other regulatory statutes and regulations.

43. If this Court fails to enjoin the continuation of the administrative proceedings that have been initiated by the March Notice of Charges, MCorp and MCorp Management will be compelled to defend those charges because they believe they are without merit. The defense of those charges will have a significant impact on the business and affairs of MCorp and MCorp Management. As of this date, MCorp, MCorp Financial and MCorp Management have assets consisting of financial assets with a value of approximately $350 million, five remaining Banks, MVestment and several non-bank subsidiaries. The approximate total value of the assets of the debtors is about $500 million. The indebtedness of those entities is approximately $500 million to $525 million on account of debt for money borrowed, including interest to March 31, 1989. There are other contingent liabilities of the Debtors as well as disputed claims against the Debtors.

44. It is the intention of MCorp to reorganize around the nucleus of the $500 million of assets, including the

five remaining MBanks. Steps already have been taken to begin that effort. Those steps include the preliminary development of a business plan that will form the nucleus and cornerstone of a plan of reorganization for the Debtors.

45. MCorp Management today employs approximately 32 people, 8 of whom are considered management level employees. The remaining employees are secretarial, clerical and administrative support personnel. The efforts to reorganize MCorp are being carried on by the eight management level employees. They also have responsibility to supervise and manage the five remaining MBanks, the trust and advisory businesses owned by MVestment and MTrust Corp, the non-bank subsidiaries, and the financial assets.

46. In addition, those persons are responsible for the conduct of litigation brought by MCorp against the Comptroller and the FDIC that is pending in the United States District Court for the Northern District of Texas, and that is described in the First Amended Complaint that is Exhibit 11. In addition, they are the people who have put together all of the schedules, statements of affairs and lists of executory contracts of the debtors filed with the Bankruptcy Court, have prepared and will prepare the reports required by the United States Trustee, and have met and will meet with and provide significant quantities of information to the creditors' committee. They are also responsible for providing information to counsel for the Debtors in order to prepare applications that are made to the Bankruptcy Court in the chapter 11 cases. Virtually all actions relating to the assets and businesses of the three Debtors that are outside the ordinary course of business, that relate to the retention of professionals, the sale or disposition of assets, the rejection of executory contracts, and all other activities requiring approval of the Bankruptcy Court, are initiated by the eight management level personnel who have to provide the necessary information to counsel. They then review and approve applications to the Court and other documents that are prepared by counsel.

47. If these persons are required to participate in the defense of the March Notice of Charges brought by the Board, their efforts with respect to the other activities described above will be sidetracked and the reorganization effort will be impaired and delayed significantly.

48. The Board has advised the Administrative Law Judge appointed to determine the charges brought by the March Notice of Charges that it will require a four to six week period to take discovery in connection with the March Notice of Charges and approximately three days of trial time to present the Board's case. MCorp will have to undertake similar discovery efforts and MCorp's defense of the charges probably will consume a similar period of about three days. Furthermore, many of the books, records and other data concerning those transactions are not in the possession and control of MCorp or MCorp Management. They are in the possession and control of the Deposit Insurance Bridge Bank or the FDIC, as receiver of MBank Dallas and MBank Houston.

49. If MCorp is required to defend the charges in the October Notices of Charges that it believes are moot, similar efforts at discovery and trial time by the Board and MCorp will multiply the involvement of the management personnel of MCorp Management. In addition, in either case MCorp will be forced to incur substantial legal expense to its counsel for the defense of those charges.

50. If the proceedings in respect of the March Notice of Charges are not stayed, and should the Board prevail in establishing that MCorp Management is indebted to the receivership estates of MBank and MBank Houston, the Board will not be the beneficiary of any moneys that are required to be paid to those receivership estates. The beneficiary of any such claims will be the FDIC, as receiver or the Deposit Insurance Bridge Bank

if those claims have been assigned by the receiver to the Bridge Bank.

51. MCorp proposes that a far more efficient way to determine whether any moneys are owed by MCorp Management to MBank Dallas or MBank Houston or the receiver of those entities—or whether those entities are in fact indebted to MCorp Management, would be through the proof of claim process provided for by the Bankruptcy Code, and not through the administrative proceedings initiated by the Board. If those claims are established, they would, in any event, be paid pursuant to a confirmed plan of reorganization for MCorp Management and the other Debtors.

52. No useful purpose can be served by continuing a lengthy, burdensome and expensive regulatory proceeding to determine whether, in fact, the assumption of the contingent payment obligation by MCorp Management was a technical violation of Section 23A of the Federal Reserve Act. The creditors and stockholders of the Debtors should not be burdened by the Board's compelling MCorp and MCorp Management to be subjected to the regulatory proceedings relating to this three-year-old transaction.

Respectfully submitted,

WEIL, GOTSHAL & MANGES
Co-Attorneys for MCorp,
MCorp Financial and
MCorp Management
700 Louisiana, Suite 1600
Houston, Texas 77002
(715) 546-5000

By /s/ Alan B. Miller
A Member of the Firm

and

HUGHES & LUCE
Co-Attorneys for MCorp,
MCorp Financial and
MCorp Management
1717 Main Street
Dallas, Texas 75201
(214) 959-5500

Dated: Houston, Texas
June 2, 1989

UNITED STATES BANKRUPTCY COURT
SOUTHERN DISTRICT OF TEXAS
HOUSTON DIVISION

Jointly Admin. Chap. 11 Case Nos. 89-02312-H3-11,
89-02324-H5-11, and 89-02848-H2-11
Adversary Proc. No. 89-0298

IN RE: MCORP FINANCIAL, INC., ETC.,
MCORP MANAGEMENT, and MCORP, ETC., DEBTORS.

MCORP, MCORP FINANCIAL, INC., and
MCORP MANAGEMENT, DEBTORS IN POSSESSION,
PLAINTIFFS

v.

THE BOARD OF GOVERNORS OF THE
FEDERAL RESERVE SYSTEM OF THE
UNITED STATES OF AMERICA, DEFENDANT

[Filed: June 2, 1989]

**SUPPLEMENTARY OFFER OF PROOF
RE MAY 24, 1989 NOTICE OF CHARGES**

MCORP, MCORP FINANCIAL, INC. and MCORP MANAGEMENT hereby make the following offer of proof in support of their Emergency Motion for a Preliminary Injunction in the above-captioned adversary proceeding:

Peter Bartholow, Chief Financial Officer and Group Chairman—Planning and Finance of MCorp and MCorp Management and President and a Director of MCorp Financial, Inc. ("MCorp Financial") will testify to the following facts:

1. The May 24, 1989 Notice of Charges issued by the board to MCorp (the "May Notice of Charges") alleges that three of the remaining MBanks have primary capital ratios below 5.5 percent of their total assets, the minimum ratio established for such banks by regulations of the Comptroller, the primary regulator of the MBanks. The May Notice of Charges further alleges that to increase the primary capital ratio of those banks to the minimum level established by the Comptroller's regulations, additional capital investments of approximately $21 million would be necessary.

2. The May Notice of Charges also alleges that all five of the remaining MBanks are experiencing deposit erosion and four of the five remaining MBanks are incurring losses. MCorp disputes these allegations of the Board.

3. Although the May Notice of Charges alleges that the Comptroller sent letters to each of the remaining MBanks requesting that they submit to the Comptroller, the primary regulator, within thirty days of the receipt of such letters capital plans designed to increase and/or maintain the capital of such banks at appropriate levels, it fails to disclose that the Comptroller has extended to June 30, 1989, the time of such banks to submit those plans to the Comptroller.

4. MCorp alleges that the remaining MBanks will submit to the Comptroller, their primary regulator, plans to increase and/or maintain the capital of such banks at appropriate regulatory standards on or before June 30, 1989, unless the time to do so is further extended by the Comptroller.

5. Furthermore, prior to May 24, 1989, MCorp recognized the fact that three of the five remaining MBanks

may require additional capital even though there is no erosion of their deposits which has had an adverse effect on liquidity of the banks and those banks currently are operating and are expected to operate on a break even or profitable basis. To that end, on May 22, 1989, MCorp proposed to the Official Creditors' Committee appointed by the United States Trustee to serve in these chapter 11 cases, that it would make capital contributions to those MBanks provided that such capital contributions are approved by order of the Bankruptcy Court.

6. Prior to making the proposal to the Official Creditors' Committee, officers of MCorp met with the senior management of each of the three MBanks (and the other two MBanks) and obtained from them their respective operating plans, projected balance sheets, income statements and other projections relating to the operations of those MBanks for the balance of 1989 and for the year 1990. That information was furnished to the members of the Official Creditors' Committee on May 22, 1989.

7. The Official Creditors' Committee requested that MCorp provide additional information to the Official Creditors' Committee in respect of the proposed capital contributions and indicated that it would again consider MCorp's proposal at a meeting scheduled to be held on June 13, 1989. MCorp intends to comply with those requests of the Official Creditors' Committee.

8. The May Notice of Charges requires that MCorp answer those charges or or before June 13, 1989 and schedules a hearing on the May Notice of Charges for July 12, 1989, for the purpose of taking evidence on the charges specified therein.

9. MCorp has been advised by counsel that it may not make capital contributions to the five remaining MBanks without authorization to do so by order of the Bankruptcy Court granted pursuant to section 363(b) of the Bankruptcy Code. Otherwise, MCorp would be in violation of section 363(b) of the Bankruptcy Code and would be subject to sanctions by the Bankruptcy Court which

might include, among other things, the appointment of a trustee pursuant to section 1104(a) of the Bankruptcy Code or the appointment of an examiner pursuant to section 1104(b) of the Bankruptcy Code.

10. The May Notice of Charges represents a premature action by the Board, that is not even the primary regulator of the five remaining MBanks. In my opinion the Board should have given the Comptroller the opportunity to receive and review the capital raising plans of the three MBanks whose capital allegedly is below the minimum capital ratio requirements of the Comptroller. It would be an unnecessary, wasteful and burdensome obligation that would deplete the financial and other resources of MCorp and the other Debtors, without serving any useful purpose whatsoever, to require MCorp to respond to and litigate the May Notice of Charges prior to (a) consideration by the Comptroller of the capital plans that are to be submitted by three of the remaining MBanks, (b) prior to MCorp having had a reasonable opportunity to seek the concurrence of the Official Creditors' Committee to make capital contributions to the three remaining MBanks and (c) approval of the Bankruptcy Court of such action pursuant to section 363(b) of the Bankruptcy Code.

Respectfully submitted,

WEIL, GOTSHAL & MANGES
Co-Attorneys for MCorp,
MCorp Financial and
MCorp Management
700 Louisiana, Suite 1600
Houston, Texas 77002
(715) 546-5000

By: /s/ Alan B. Miller
A Member of the Firm

and

HUGHES & LUCE
Co-Attorneys for MCorp,
MCorp Financial and
MCorp Management
1717 Main Street
Dallas, Texas 75201
(214) 959-5500

Dated: Houston, Texas
June 2, 1989

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF TEXAS
HOUSTON DIVISION

Civil Action No. H-89-1677

MCORP, ET AL., PLAINTIFFS, and
OFFICIAL CREDITORS' COMMITTE OF MCORP,
MCORP FINANCIAL, INC., and
MCORP MANAGEMENT, INTERVENOR

v.

THE BOARD OF GOVERNORS OF THE FEDERAL RESERVE
SYSTEM OF THE UNITED STATES OF AMERICA, DEFENDANT

[Filed: Jan. 2, 1991]

ORDER

Since the modified preliminary injunction resolves all issues pending the decision of the United States Supreme Court, this case is closed except for enforcement on a motion of a party or modification on remand.

Signed on December *27th*, 1990, at Houston, Texas.

/s/ Lynn N. Hughes
LYNN N. HUGHES
United States District Court

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF TEXAS
HOUSTON DIVISION

Civil Action No. H-89-1677

MCORP, ET AL., PLAINTIFFS, and
OFFICIAL CREDITORS' COMMITTEE OF MCORP,
MCORP FINANCIAL, INC., and
MCORP MANAGEMENT, INTERVENOR

v.

THE BOARD OF GOVERNORS OF THE FEDERAL RESERVE
SYSTEM OF THE UNITED STATES OF AMERICA, DEFENDANT

[Filed: Jan. 2, 1991]

INJUNCTION ON REMAND

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1. *Parties.*

   A. The parties plaintiff are:

      (1) MCorp, a bank holding company;

      (2) MCorp Financial, Inc., a non-bank subsidiary of MCorp; and

      (3) MCorp Management, a non-bank subsidiary of MCorp.

      (4) All the plaintiffs are debtors in possession.

   B. The Official Creditors' Committee of MCorp, MCorp Financial, Inc., and MCorp Management under § 1102 of the Bankruptcy Code is an intervening party plaintiff.

   C. The party defendant is the Board of Governors of the Federal Reserve System of the United States of America.

2. *Related Proceedings.* This civil action is an adversary proceeding in the consolidated chapter 11 cases of the debtors, and the reference of it by the district court to the bankruptcy court was withdrawn. Adversary Proceeding 89-0298. The other actions are:

   A. An involuntary petition was filed in the Southern District of New York against MCorp, and it was transferred here to pend under Case 89-02324-H5-11.

   B. A voluntary petition was filed in the Southern District of Texas by MCorp Management under Case 89-02324-H5-11.

   C. A voluntary petition was filed in the Southern District of Texas by MCorp Financial, Inc., under Case 89-02312-H3-11.

   D. The three bankruptcy actions have been consolidated under 89-02312-H3-11 for joint administration.

3. *Prior Proceedings.*

   A. On June 2, 1989, the court preliminarily enjoined the Board from prosecuting certain administrative proceedings. The court issued a preliminary injunction on June 3, 1989, and amended it on June 19, 1989.

   B. On August 23, 1990, the United States Court of Appeals for the Fifth Circuit issued the mandate reversing and vacating a portion of the prelimi-

nary injunction and remanding the case with instructions to enjoin the Board from prosecution of certain charges.

C. In accordance with the mandate, the preliminary injunction is modified and restated.

4. *Restraint.* The court decrees that:

The Board is enjoined from prosecuting an administrative proceeding against the debtors:

A. For an order to compel the debtors to

(1) Transfer property to their present or former subsidiary banks (or successors in interest to, or assignee of, those banks) or

(2) Take or refrain from taking any action in respect to the debtors' properties; or

B. Enforce the Board's source of strength doctrine or

C. Regulate the day-to-day financial soundness of the subsidiary banks.

5. *Reasons.* The court grants the restraint because:

A. A significant threat of irreparable harm to the plaintiffs exists if the injunction is not granted.

(1) Forcing the holding company to transfer funds to the subsidiary banks results in a wasting of corporate assets and violates the company's duty to its shareholders.

(2) The transfer of funds also deprives MCorp of its own separate corporate status.

B. The extent of harm to the plaintiffs resulting from failure to grant this order outweighs the Board's interest in supervising bank holding companies.

(1) The order does not impair:

(a) The Board's authority to determine the legitimacy of the transactions between

the closed banks and the holding company; or

(b) The Board's authority to prosecute charges under section 23A.

(2) The Board's interest in supervising bank holding companies does not include forcing a transfer of funds to the bank subsidiaries. The Board's interests, therefore, are unaffected by this order.

(3) An important purpose of the Bank Holding Company Act is to separate banking from commercial enterprises. Allowing the Board to treat the holding company as an extension of its bank subsidiaries undermines that purpose.

C. The plaintiffs will likely succeed on the merits of the case.

(1) The Board's interpretation of "unsafe and unsound" banking practices is unreasonable and impermissible and thus the Board may not require the transfer of holding company funds to the bank subsidiaries.

(2) MCorp is not required to exhaust its administrative remedies before seeking judicial relief because MCorp challenges the Board's legal authority to enforce the source of strength doctrine as a means to prevent unsafe and unsound banking practices.

(a) No facts are in dispute that require MCorp to exhaust its administrative remedies in the Board's proceedings.

(b) Congress has specified unsound transactions between bank holding companies and their bank subsidiaries, and it has never

mentioned the failure to inject capital into a bank subsidiary as an unsafe and unsound practice.

(3) A plain reading of 12 U.S.C. § 1818(i) indicates that the district court has jurisdiction to enjoin the Board if the Board exceeds it statutory authority.

D. The public interest is served by granting this injunction.

An effective and efficient bankruptcy reorganization, free from undue administrative interference, will proceed.

6. *Signing.*

Signed on December 27, 1990, at Houston, Texas.

/s/ Lynn N. Hughes
LYNN N. HUGHES
United States District Judge

SUPREME COURT OF THE UNITED STATES

No. 90-913

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM OF THE UNITED STATES, PETITIONER

v.

MCORP FINANCIAL, INC., ET AL.

ORDER ALLOWING CERTIORARI

Filed March 4, 1991

The petition herein for a writ of certiorari to the United States Court of Appeals for the Fifth Circuit is granted. This case is consolidated with 90-914, *MCorp, et al. v. Board of Governors of the Federal Reserve System of the United States* and a total of one hour is allotted for oral argument.

March 4, 1991

SUPREME COURT OF THE UNITED STATES

No. 90-914

MCORP, ET AL., PETITIONERS

v.

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM OF THE UNITED STATES

ORDER ALLOWING CERTIORARI

Filed March 4, 1991

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March 4, 1991

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